No. 90-1628

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IN THE

Supreme Court of the United States

October Term, 1990

NORTHWEST SAVINGS BANK, PaSA, CADRE CAPITAL, FINANCIAL CENTRE SECURITIES, NORMAN BALLARD, EDNA LOU BALLARD and JOHN ROBERTS,

Petitioners,

vs.

WILLIAM WELCH III, ANDREW GUEST and ELIZABETH GUEST,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. With respect to claims brought pursuant to Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, should a decision adopting a uniform federal limitations period of one year from the date of the discovery of the alleged fraud, but in no event more than three years after the alleged violation, be applied retroactively?

2. Does this Court's opinion in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971) require that the party seeking to avoid retroactive application of a judicial decision establish all three elements of the test set forth in that case to satisfy the exceptional circumstance of prospective only application?

LIST OF PARTIES

In addition to the petitioners, R. Laken Mitchell and Mutual Fire, Marine and Inland Insurance Company are defendants in the district court proceeding.

There are no parent or subsidiary companies to be listed pursuant to Rule 29.1 in regard to the petitioners.

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PETITION FOR WRIT OF CERTIORARI

I. OPINIONS BELOW

The opinion of the Court of Appeals below (Appendix, *infra*, p. 1a-16a) is reported at 923 F.2d 989 (2d Cir. 1991). The Opinion of the District Court below (Appendix, *infra*, p. 19a-60a) is reported at 735 F. Supp. 467 (D. Conn. 1990).

II. STATEMENT OF JURISDICTION

The judgment of the Court below (Appendix, *infra*, p. 17a-18a) was entered on January 22, 1991. Rehearing was not sought. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

III. FEDERAL STATUTES AND REGULATIONS INVOLVED

Claims were asserted against the petitioners below pursuant to the following federal statutes and regulations:

1. Securities Exchange Act of 1934—§10(b)

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. §78j(b)

2. Securities Exchange Commission Rule 10b-5

> 10b-5 Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. §240.10b-5

IV. STATEMENT OF THE CASE

A. Basis for Jurisdiction in District Court

Jurisdiction in the United States District Court for the District of Connecticut was invoked pursuant to Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa, and Section 22(a) of the Securities Act of 1933, 15 U.S.C. §77a.

B. Background

Keystone 1984-1 Oil and Gas Drilling Program ("Keystone") was a limited partnership created for the purpose of drilling at least six oil and gas wells. Petitioner Cadre Capital served as its managing underwriter.

On May 10, 1984, respondent William Welch purchased two limited partnership interests in Keystone ("units") from petitioner John Roberts. On May 25, 1984, the respondents Andrew and Elizabeth Guest purchased a total of six units from petitioners Edna Lou and Norman Ballard. The Ballards and Roberts were principals of petitioner Financial Centre Securities. The price of each unit was $20,000. At the time of purchase, $5,000 of the price of each unit was paid in cash; the balance of $15,000 was paid by a promissory note. In July of 1984, R. Laken Mitchell ("Mitchell"), counsel for Keystone, informed respondents that their promissory notes had been assigned by Keystone to petitioner Northwest Savings Bank, PaSA ("Bank") as collateral security for a loan made by the Bank to Keystone. Mutual Fire, Marine and Inland Insurance Company ("Surety") issued financial guaranty bonds to guarantee the payment of the respondents' notes which had been assigned to the Bank.

Respondents contend that they first learned of the demise of Keystone in early 1987. Welch claims to have heard of Keystone's financial difficulties in January of 1987 from John Roberts. The Guests claim to have remained unaware of Keystone's difficulties until March of 1987, when Financial Centre Securities informed them of Keystone's insolvency.

C. Cause of Action

Respondents brought suit on October 17, 1988, in the United States District Court for the District of Connecticut against the petitioners, Mitchell and the Surety, alleging fraud and misrepresentation in the sale of their Keystone units. The Complaint alleged six counts involving federal securities claims, as well as state law statutory and common law claims. The first two counts alleged causes of action under §§5(a), 5(c), 12 and 17 of the Securities Act of 1933 (" '33 Act"), §10(b) of the Securities Exchange Act of 1934 (" '34 Act") and Rule 10b-5 of the Securities Exchange Commission. With regard to the Bank and the Surety, the respondents alleged primary violations of the '34 Act as well as aiding and abetting of other defendants in the commission of securities fraud. The other four counts sought relief for alleged violations of the anti-fraud provisions of the Connecticut Uniform Securities Act (Conn. Gen. Stat. §36-498), common law fraud, breach of fiduciary duty and negligent misrepresentation.

D. Motions to Dismiss

In response to respondents' Complaint, petitioners filed motions to dismiss on various grounds. By Order dated August 17, 1989, the district court granted dismissal of the '33 Act claims, and requested additional briefing regarding the period of limitations applicable to

the '34 Act claims. In their motions to dismiss, petitioners asserted that the appropriate period of limitations for these claims was one year from the date of discovery of the alleged fraud, but in no event more than three years after the alleged violation. That limitations period had first been adopted by the United States Court of Appeals for the Third Circuit in *In Re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir. 1988), *cert. denied sub nom. Vitiello v. I. Kahlowsky and Company*, 488 U.S. 849, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988).

Following the additional briefing, the district court entered an Order dated April 12, 1990, in which it adopted the one year/three year period of limitations. The district court also ruled that this new period of limitations should be applied retroactively. Because respondents had filed their action more than one year after discovery of the alleged fraud and more than three years after the alleged violation, the '34 Act claims were dismissed by the district court.[1] Because all of the federal claims were dismissed, the district court then dismissed the pendent state claims by Order dated May 24, 1990, and judgment was entered in favor of petitioners and against respondent on May 25, 1990.

E. Court of Appeals Decision

Without waiting for the entry of judgment, respondents filed an appeal to the United States Court of Appeals for the Second Circuit on May 2, 1990, from the

[1] Although their action was not filed until October of 1988, the respondents admitted having knowledge of Keystone's insolvency, and thus, any alleged fraud, not later than March of 1987. In addition, all units were purchased in May of 1984 and any alleged violation would have occurred at that time, more than three years before commencement of the action.

district court's April 12, 1990 Order. The issue before the Court of Appeals was the propriety of the district court's adoption of the one year/three year period of limitations. Respondents did not appeal from the district court's decision to apply that period retroactively. The Court of Appeals heard argument on September 26, 1990, and took the matter under advisement. On November 8, 1990, the Court of Appeals decided *Ceres Partners v. GEL Associates,* 918 F.2d 349 (2d. Cir. 1990), in which it joined the Third and Seventh Circuits in adopting a one year/three year period of limitations for actions brought pursuant to §10(b) of the '34 Act and Rule 10b-5.[2] On January 22, 1991, the Court of Appeals decided this case. In its Opinion, the Court concluded that it would not apply the one year/three year period which it had adopted in *Ceres Partners* retroactively, as the Court of Appeals for the Third Circuit had done in *Hill v. Equitable Trust Co.,* 851 F.2d 691 (3d Cir. 1988), *cert. denied,* 488 U.S. 1008, 109 S.Ct. 791, 102 L.Ed.2d 782 (1989). As a result, it reversed the decision of the district court and remanded the case for further proceedings.

[2] The one year/three year period of limitations was adopted by the United States Court of Appeals for the Seventh Circuit in *Short v. Belleville Shoe Manufacturing Company,* 908 F.2d 1385 (7th Cir. 1990).

V. REASONS FOR GRANTING THE WRIT OF CERTIORARI

A. Introduction

As noted above, the United States Court of Appeals for the Third Circuit elected to apply the one year/three year period of limitations announced in *Data Access* retroactively in *Hill v. Equitable Trust Co., supra*, and in two cases which followed *Hill. See Gatto v. Meridian Medical Associates, Inc.*, 882 F.2d 840 (3d Cir. 1989), *cert. denied*, _____ U.S. _____, 110 S.Ct. 1136, 107 L.Ed.2d 1041 (1990); *McCarter v. Mitcham*, 883 F.2d 196 (3d Cir. 1989). The Court of Appeals for the Second Circuit reached an opposite conclusion in this case. Thereafter, in *Gruber v. Price Waterhouse*, 911 F.2d 960 (3d Cir. 1990), the Third Circuit opted against retroactive application of the new period of limitations in that particular case.

A review of these two lines of cases reveals an emerging pattern which suggests two differing views of the requirements imposed by this Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971) for determining when new principles of law will be limited to prospective application. As a result of this conflict among the Second and Third Circuits in the application of the *Chevron* test, the uniformity which both courts sought to achieve by adopting a federally-based period of limitations for §10(b) and Rule 10b-5 claims is in danger of being destroyed.[3] Furthermore, this conflict may affect the application of this Court's

[3] Conflicts among federal courts relating to the application of established principles of law have formed the basis for the issuance of writs of certiorari. *See, e.g., Oregon Dept. of Fish and Wildlife v. Klamath Indian Tribe*, 473 U.S. 753, 105 S.Ct. 3420, 87 L.Ed.2d 542 (1985); *Saxbe v. The Washington Post Co.*, 417 U.S. 843, 846, 94 S.Ct. 2811, 41 L.Ed.2d 514 (1974).

anticipated decision in *Lampf, Plena, Lipkind, Prupis & Petigrow v. Gilbertson*, No. 90-333, in which this Court is considering the adoption of a uniform period of limitations for claims under §10(b) and Rule 10b-5. Because the application of the *Chevron* test is an important issue of federal law generally, and in federal securities cases in particular, petitioners contend that substantial reasons exist to grant a writ of certiorari.

B. The Period of Limitations

Since the first recognition of an implied right of action under §10(b) of the '34 Act by the inferior federal courts more than forty years ago, until the Third Circuit's *Data Access* decision in 1988, federal courts have borrowed from the law of the forum state to determine the appropriate period of limitations to be applied.[4] Over the years, this practice has resulted in a crazy quilt of conflicting limitations periods, and has evoked much criticism by courts and commentators alike.[5] Since the

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[4] In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), this Court noted that a private right of action under §10(b) of the '34 Act was first implied in 1946 in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) (425 U.S. at 196, n.16). The borrowing of analogous state statutes of limitation began shortly thereafter. *See, e.g., Osborne v. Mallory*, 86 F. Supp. 869, 879 (S.D.N.Y. 1949); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951).

[5] For example, in *Norris v. Wirtz*, 818 F.d 1329, 1332 (7th Cir.), *cert. denied*, 484 U.S. 943, 108 S.Ct. 329, 98 L.Ed.2d 356 (1987), Judge Easterbrook colorfully described the absence of a uniform limitations period in securities actions as "one tottering parapet of a ramshackle edifice." 818 F.2d at 1332. Judge Easterbrook further commented that:

> Never has the process [of borrowing state statutes of limitations] been more enervating than in securities law. There are many potentially analogous state statutes, with variations

(Footnote continued on following page.)

Third Circuit's decision in *Data Access*, which adopted a federally-based period of limitations, there has been a substantial amount of litigation in the Courts of Appeals which has radically altered the landscape of federal securities claims. Following the Third Circuit's lead, the Seventh Circuit in *Short v. Belleville Shoe Manufacturing Co.*, *supra*, and the Second Circuit in *Ceres Partners*, *supra*, have adopted the one year/three year limitations rule derived from the '34 Act. This rule bars any suit filed more than one year after discovery of the alleged fraud or more than three years after the alleged violation. Other Courts of Appeals have declined to follow the Third Circuit's lead, and have continued to apply limitations periods derived from analogous state law.[6] In apparent recognition of the compelling need to resolve this issue, this Court granted certiorari on October 9, 1990, at No. 90-333 in the case of *Lampf, Plena, Lipkind, Prupis & Petigrow v. Gilbertson.* Argument in that case was heard on February 19, 1991.

The three circuits which have adopted the federal period of limitations have done so to eliminate the injustice which had evolved over the past 50 years, whereby the viability of a litigant's claim was frequently more dependent upon geography than on the merits of

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(Footnote continued from preceding page.)

> for different kinds of securities offenses and different circumstances that might toll the period of limitations. Both the bar and scholars have found the subject vexing and have pleaded, with a unanimity rare in the law, for help .... As the ABA's Committee on Federal Regulation of Securities observed ... the courts of appeals disagree on every possible question about limitations periods in securities cases.

Id. (citations omitted). *See also* L. Loss, *Fundamentals of Securities Regulation* 992-1003 (2d ed. 1988 & Supp. 1989).

[6] *See, e.g., Nesbit v. McNeil*, 896 F.2d 380, 384 (9th Cir. 1990); *Smith v. Duff & Phelps, Inc.*, 891 F.2d 1567, 1570 (11th Cir. 1990).

the case. However, the injustice complained of by courts and commentators alike will not end with a decision in *Lampf, Plena* even if this Court should decide to adopt a uniform federal period of limitations. So long as the Courts of Appeals remain divided on the issue of retroactivity, new confusion and uncertainty will be injected into an area which, after many years, is finally being clarified.

C. The Retroactivity Issue

It is a well-established rule that judicial precedents are generally applied retroactively as well as prospectively. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526, 527 (1989); *Thorpe v. Housing Authority of City of Durham*, 393 U.S. 268, 281, 89 S.Ct. 518, 21 L.Ed.2d 474 (1969). Thus, a controversy should generally be decided on the law as it exists at the time the appellate court considers the case, although the law may differ from the one in force at the time the trial court decided the matter. *St. Francis College v. Al-Khazraji*, 481 U.S. 604, 608, 107 S.Ct. 2022, 95 L.Ed.2d 582 (1987); *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 486 n.16, 101 S.Ct. 2870, 2879, 69 L.Ed.2d 784 (1981). Only specific and limited circumstances warrant denying a precedent retroactive effect. *Rodriguez de Quijas v. Shearson/American Express, Inc., supra; Chevron Oil Co. v. Huson, supra.*

Recognizing these unquestioned principles, the Third Circuit held in *Hill v. Equitable Trust Co., supra*, that the *Data Access* holding should be applied retroactively. The Third Circuit concluded that the *Data Access* decision was *not* an "uncommon exception" which should be limited to prospective application only. 851 F.2d at 698-699. In so holding, the *Hill* court was guided by this Court's teaching in *Chevron Oil Co. v. Huson, supra,*

which established a three-part test for determining whether a given precedent should be applied only prospectively:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed . . .. Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-107 (citations omitted).

In this case, the district court concluded that all three parts of the *Chevron* test must be satisfied in order to permit deviation from the established rule that decisions are to be given both prospective and retroactive effect. 735 F. Supp. at 482. Relying on *Cash v. Califano*, 621 F.2d 626, 629 (4th Cir. 1980), the district court also concluded that the party opposing retroactive application bears the burden of satisfying the test. *Id.* The district court found, based on its interpretation of the holding of *Chevron*, that respondents had failed to meet their burden of establishing all three elements (or indeed any element) of the test; therefore, it gave its ruling retroactive effect and dismissed the respondents' Complaint. Similarly, the Third Circuit in *Hill*, although not specifically stating that proof of all three *Chevron*

elements was necessary to deny retroactive effect, nevertheless determined that all three elements were not present. That determination clearly formed the basis for its decision to apply the one year/three year period of limitations retroactively. Similar conclusions were reached in the Third Circuit in its *Gatto* and *McCarter* decisions.[7]

The Court of Appeals for the Second Circuit, while recognizing that respondents not only failed to meet, but did not even attempt to meet their burden, nevertheless concluded that it would not apply its decision in *Ceres* retroactively in this case.

In reviewing the Second Circuit's application of the *Chevron* test, it appears that the Second Circuit has a much more liberal view of what constitutes the "exceptional circumstances" necessary to preclude retroactive effect than does either the district court, the Third Circuit or indeed most of the other Courts of Appeals. More importantly, it also appears that the Second Circuit's approach to the application of the *Chevron* factors deviates from that directed by this Court in its *Chevron* opinion and later cases which discuss its holding. An examination of the Second Circuit's application of each part of the *Chevron* test in this case clearly demonstrates this point.

The first part of the *Chevron* test requires prior precedent to have been established to the degree that a plaintiff could have reasonably relied upon it in delaying suit. 404 U.S. at 106-107. According to the *Hill* court, this analysis requires a court to examine the state of the

[7] By contrast, the Third Circuit in *Gruber v. Price Waterhouse, supra,* in deciding that *Data Access* should be applied only prospectively in that case, found the first and third *Chevron* factors to favor prospective application, with the second factor being neutral.

law at the time at which a plaintiff could have discovered the alleged violation *and* at the date on which the suit was filed. 851 F.2d at 697.

In this case, the sales of the securities at issue occurred in May of 1984, and the respondents have alleged that petitioners' violations of the securities laws commenced at that time. It is further alleged that respondents did not discover those violations until, at the very latest, March of 1987. Respondents did not file this action until October 17, 1988.

In March of 1987, when respondents claim to have discovered the alleged violations, the law of the Second Circuit directed district courts to choose an analogous law of the forum state to determine the proper limitations period. *See IIT, an International Investment Trust v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980). The Second Circuit itself had never addressed the issue of an appropriate analogy for cases arising in Connecticut, although there were, as is typically the case, several candidates from which to choose.[8] Thus, on the date they discovered the alleged fraud, and on the later date when they filed this action, there was no definitive Second Circuit precedent on which respondents could have reasonably relied.

More significantly, however, three decisions by this Court—*DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151, 103 S.Ct. 2281, 76 L.Ed.2d 476 (1983), *Wilson v. Garcia*, 471 U.S. 261, 105 S.Ct. 1938, 85

[8] The three courts in the District of Connecticut which considered this issue prior to the decision in this case had concluded that Conn. Gen. Stat. §36-498(e) (or its predecessor, §36-346(e)) was the "most analogous" state law. *See Clute v. Davenport, Co.*, 584 F. Supp. 1562, 1577 (D. Conn. 1984); *Dandorph v. Fahnestock & Co.*, 462 F. Supp. 961, 963, n.4 (D. Conn. 1979); *Hitchcock v. deBruyne*, 377 F. Supp. 1403, 1407 (D. Conn. 1974).

L.Ed.2d 254 (1985) and *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1987)—which together unquestionably cast doubt on such prior Second Circuit authority as did exist—had *all* been decided by April of 1987, only one month after the alleged discovery and at least seventeen and one-half months prior to the filing of this action. Those cases draw into serious question the prior practice of borrowing state limitations periods when federal legislation creating federal causes of action is silent on the issue of limitations. In the view of the district court, "This should have caused a reasonably prudent attorney to at least question the value of precedent in [the District of Connecticut]." 735 F. Supp. at 483. Furthermore, *Data Access* was decided six months prior to the date on which respondents filed suit, making it evident that at least one federal Court of Appeals believed that *Malley-Duff* was applicable to §10(b) and Rule 10b-5 actions. Thus, by the time respondents filed this action, even a casual observer of the federal securities law would have necessarily concluded that the continued viability of the historical "borrowing" rule was subject to considerable doubt.

Despite its recognition that the respondents made no effort to satisfy the first part of the *Chevron* test, and despite a compelling analysis by the district court regarding this issue, the Second Circuit nevertheless concluded that its *Ceres* decision overruled sufficiently clear circuit precedent to have satisfied the first *Chevron* factor. In so doing, the court said that:

> Though some of the Supreme Court decisions forming the doctrinal foundation for *Ceres*' rejection of the borrowing approach had already been decided by 1987, around the time plaintiffs discovered the alleged fraud . . ., the impending revision of a

> limitations period for 10b-5 claims was not so clearly foreshadowed that plaintiffs were chargeable with its prediction.

Welch v. Cadre Capital, 923 F.2d at 994 (citations omitted).

This conclusion by the Second Circuit is inconsistent with the requirement of the first prong of the *Chevron* test, which requires a finding that respondents could have *relied* on prior precedent. This reliance element suggests the absence of any reasonable, objective basis to question the continuing viability of existing precedent. This is clearly not the case here, where a trilogy of cases decided by this Court draw into serious doubt the philosophical underpinnings of the "borrowing" concept for periods of limitations. Moreover, the Second Circuit's interpretation clearly runs counter to the presumption of retroactivity that is the point of beginning of any *Chevron* analysis.

Similarly, respondents failed to meet the remaining two *Chevron* criteria. With regard to the second criterion, whether retroactive operation would further or retard the new rule's application, respondents failed to provide the lower court with any insight as to why the purposes of the securities laws would be hindered by retroactive application of the new federal limitations rule. No reason is readily apparent. On the other hand, significant reasons exist for applying the new rule retroactively. First, as the Third Circuit noted in *Data Access*, by failing to apply a uniform period of limitations, courts fail to promote the compelling federal interests of "uniformity, certainty and the minimization of unnecessary litigation." 843 F.2d at 1543. Applying the general rule of retroactivity fosters more uniformity and certainty than continuing to apply state statutes of

limitations, which vary widely in length.[9] Accordingly, as the district court noted, "[A]llowing plaintiffs to maintain a suit more than a year and a half after the [three-year] statute of repose [dictated by *Data Access*] has expired would frustrate . . . the schema of the 1934 Act." 735 F. Supp. at 484. Thus, petitioners also have failed to establish the second *Chevron* criterion.

Even the Second Circuit recognized the validity of the petitioners' position with respect to the second *Chevron* factor. It noted that "[a]pplication of the second *Chevron* factor—effect of retroactive application upon the rule in question—is more problematical." 923 F.2d at 994. It recognized that "if 'the rule in question' is the new limitations period itself, its retroactive application will always further the new rule: A new, shorter period will end a law suit filed beyond the new limits, and a new, longer period will allow a lawsuit otherwise barred." *Id.* Nevertheless, the Second Circuit refused to accord great weight to this criterion, saying, "We doubt if the Court in *Chevron* contemplated such a mechanical inquiry." *Id.* Rather, the Court of Appeals, disagreeing with the district court, concluded that the "purposes of the '34 Act will not be impaired by continuation of a handful of lawsuits filed within the longer time limits of previously applicable state law." 923 F.2d at 995. Again, the Court of Appeals failed to require an affirmative showing that respondents actually satisfied an integral part of the *Chevron* test; rather, it was content to conclude that

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[9] *See, e.g., Jensen v. Snellings*, 841 F.2d 600 (5th Cir. 1988), applying Louisiana's two year Blue Sky period; *Teamsters Local 282 Pension Trust Fund v. Angelos*, 815 F.2d 452 (7th Cir. 1987), applying Illinois three year Securities Act period; *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852, 91 S.Ct. 47, 27 L.Ed.2d 90 (1970), applying Arkansas two year Blue Sky period; *Metropolitan Securities v. Occidental Petroleum Corp.*, 705 F. Supp. 134 (S.D.N.Y. 1989), applying New York's six year general fraud period.

limiting *Ceres* to prospective application would cause no harm. Such an interpretation is clearly contrary to the principle that only "exceptional circumstances" will warrant prospective only application.

The final prong of the *Chevron* test requires a court to weigh the "inequity imposed by retroactive application." 404 U.S. at 107. While it goes without saying that respondents' claims would be barred if the one year/three year period of limitations is applied retroactively, surely more than this must be shown because this result would be obtained in every case. As one district court addressing this issue noted: "[P]laintiffs must demonstrate more than the fact that they would be deprived of an opportunity to present their claims at trial, for that is always and inevitably the result of retroactive application of a new statute of limitations rule under circumstance [sic] analogous to those here present." *Halperin v. Jasper*, 723 F. Supp. 1091, 1095 (E.D. Pa. 1989).

In this case, respondents have not made the required showing. Furthermore, respondents' own seventeen-month delay in bringing their action after the alleged discovery of the fraud factors into the balancing of inequities because their own conduct played a prominent role in using up the limitations period. By the time respondents claim to have discovered the alleged violation, their cause of action was almost three years old; they nonetheless waited an additional year and a half to file suit, a total of four and one-half years after the alleged fraudulent activity occurred. As noted by the district court, "Such laxity demonstrates both the plaintiffs' lack of reliance on *any* statute and their willingness to expose themselves to substantial risk of losing their claims." 735 F. Supp. at 484 (emphasis in the original).

Analysis of the final prong of the *Chevron* test also requires consideration of potential inequity to the petitioners. The district court itself noted that "inequity to the defendants must also be considered in this context." 735 F. Supp. at 484. Forcing defendants to litigate a claim brought against them over four years after the alleged violation constitutes a more substantial inequity than preventing those who sat back during those four years from bringing the claim. In this sense, it must be noted that statutes of limitations are "designed to protect the citizens from stale and vexatious claims, and to make an end to the possibility of litigation after the lapse of a reasonable time." *Guaranty Trust Company of New York v. United States,* 304 U.S. 126, 136, 58 S.Ct. 785, 82 L.Ed. 1224 (1938). Accordingly, the district court found that "a weighing of the equities tips the scale in favor of the defendants," and, therefore, that retroactive application of *Data Access* would not result in substantial inequities. 735 F. Supp. at 484.

Again, the Second Circuit disagreed with the district court. Stating its belief that the "equities favor the plaintiffs," the Court concluded that retroactive application of the one year/three year period "would unjustly deny plaintiffs' 'right to a day in court.' " 923 F.2d at 995 (citation omitted).

D. Conflict in the Application of the *Chevron* Test

The Second Circuit's decision in this case is the result of the application of the *Chevron* test in a way inconsistent with the manner in which this Court, as well as other Courts of Appeals, have applied *Chevron's* three factors since that case was decided. In the *Chevron* case itself, this Court analyzed each of the three factors and concluded that each one favored a prospective application of the new rule. 404 U.S. at 107-109. The

decision did not, however, specifically indicate either the importance of each factor or the relationship among them. Given this lack of guidance, the Courts of Appeals have developed various approaches to the application of the test which are significantly different from one another. These differing approaches can and, as occurred here, often do lead to inconsistent results.

One approach, favored by the Seventh Circuit, requires the opponent of retroactivity to establish all three *Chevron* factors. *See Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287, 1294 (7th Cir. 1975), *cert. denied*, 425 U.S. 943, 96 S.Ct. 1682, 48 L.Ed.2d 186 (1976); *NLRB v. Lyon & Ryan Ford, Inc.*, 647 F.2d 745, 757 (7th Cir.), *cert. denied*, 454 U.S. 894, 102 S.Ct. 391, 70 L.Ed.2d 209 (1981). Another approach, favored by the First, Fourth and Eighth Circuits, utilizes a balancing of the various *Chevron* factors. *See Fernandez v. Chardon*, 681 F.2d 42 (1st Cir. 1982), *aff'd*, 462 U.S. 650, 103 S.Ct. 2611, 77 L.Ed.2d 74 (1983); *Cash v. Califano, supra; Occhino v. United States*, 686 F.2d 1302 (8th Cir. 1982). The third approach, which appears to be used only by the Second Circuit, is the one which was used in this case. This approach considers the first *Chevron* factor, *i.e.*, reliance on prior precedent, as a threshold test for nonretroactivity. If this test is satisfied, the court then balances the remaining two. *See Kremer v. Chemical Construction Corp.*, 623 F.2d 786 (2d Cir. 1980), *aff'd*, 456 U.S. 461, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982).

Cases decided by this Court since *Chevron* strongly suggest that all three factors must be present before a new principle of law can be denied retroactive application. In *Al-Khazraji v. Saint Francis College*, 784 F.2d 505 (3d Cir. 1986), the Third Circuit found all three *Chevron* factors present and denied retroactive

application of its holding in *Goodman v. Lukens Steel Company*, 777 F.2d 113 (3d Cir. 1985), *aff'd*, 482 U.S. 656, 107 S.Ct. 2617, 96 L.Ed.2d 572 (1987) relating to the statute of limitations applicable to actions under 42 U.S.C. §1981. In affirming the Third Circuit, Justice White, speaking for this Court, said:

> The Court of Appeals found these same factors were present in this case and foreclosed retroactive application of its decision in *Goodman*. We perceive no good reason for not applying *Chevron* where *Wilson* has required a Court of Appeals to overrule its prior cases. Nor has petitioner persuaded us that there was any error in the application of *Chevron* in the circumstances existing in this case.

Saint Francis College v. Al-Khazraji, 481 U.S. at 609, 107 S.Ct. at 2026, 95 L.Ed.2d at 589. Perhaps more significant to this case is this Court's decision in *Rodriguez de Quijas v. Shearson/American Express*, *supra*. In that case, this Court considered all three *Chevron* factors in determining whether to give retroactive effect to its decision to overrule *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed 168 (1953). After discussing the general rule favoring retroactivity, Justice Kennedy said:

> Although our decision to overrule *Wilko* establishes a new principle of law for arbitration agreements under the Securities Act, this ruling furthers the purposes and effect of the Arbitration Act without undermining those of the Securities Act. Today's ruling, moreover, does not produce 'substantial inequitable results' . . ..

490 U.S. at 485, 109 S.Ct. at 1922, 104 L.Ed.2d at 537 (citation omitted).

Finally, in *American Trucking Assns., Inc. v. Smith*, _____ U.S. _____, 110 S.Ct. 2323, 110 L.Ed.2d 148 (1990), this Court considered all three *Chevron* factors and found all to be present in deciding to limit its holding in *American Trucking Assns., Inc. v. Scheiner*, 483 U.S. 266, 107 S.Ct. 2829, 97 L.Ed.2d 226 (1987) to prospective application only. It is noteworthy that in none of these cases did the Court suggest or imply in any way that a balancing of the *Chevron* factors was appropriate. Rather, it consistently held that if all three factors were present, the new principle of law would be limited to prospective application; otherwise, it would not.

E. Effect of Inconsistent Application of the *Chevron* Test

Typically, securities are sold on a nationwide basis. As such, venue for federal securities claims frequently may be properly laid in several different districts. Because prior law required borrowing the limitations period of the forum state, and because the periods used by the several states vary widely, a plaintiff with a potential securities claim cannot help but be tempted to engage in the most blatant forum shopping if his case has not been filed by the expiration of the one year/three year federal period. While the problem will, of course, abate over time if this Court endorses a federal period of limitations in its *Lampf, Plena* decision, there will undoubtedly be a number of cases which might otherwise have been filed in a district in the Third Circuit which will be filed in, for example, the Southern District of New York, because the period of limitations "borrowed" from New York is longer in the Second Circuit, and the plaintiff will have an opportunity to argue that he should not be held to the standard of *Ceres* because he had been relying on prior precedent.

In addition, with respect to all pending cases, defendants, such as petitioners here, will be forced to litigate stale claims merely because they were unfortunate enough to have been sued in the Second Circuit. Significantly, had petitioners Bank or Cadre Capital or co-defendant Mutual Fire, Marine and Inland Insurance Company, all of which are domiciled in Pennsylvania, been sued in their home circuit, they would in all likelihood have had the benefit of retroactive application of the one year/three year period.

The effect of inconsistent application of the *Chevron* test among the circuits on these petitioners is abundantly clear. However, its effect generally can be seen with equal clarity. This Court has stated, time and again, that there is a presumption that new principles of law will be applied retroactively, absent special circumstances. This presumption is being significantly eroded by an all too liberal interpretation by certain Courts of Appeals of this Court's requirements for prospective only application. Further, *Chevron* requires an inquiry into the history of the rule in question to determine whether retroactive application will further or retard its operation. Because of the inconsistent results which have obtained over the year in §10(b) and Rule 10b-5 cases as a result of use of borrowed limitations periods, it is difficult to imagine how retroactive application would not further the operation of a uniform federal period if one is adopted by this Court. Conversely, the operation of such uniform period would certainly be retarded if it is limited to prospective application only.

VI. CONCLUSION

With respect to each element of the *Chevron* test, petitioners believe that substantial arguments exist which would support a conclusion that the United States Court of Appeals for the Second Circuit misapplied the teaching of this Court. More significantly, the decision of the Second Circuit creates a split between it and the Third Circuit on the issue of application of the *Chevron* test, a conflict which potentially will affect a substantial number of pending cases, depending upon this Court's anticipated decision in *Lampf, Plena, Lipkind, Prupis & Petigrow v. Gilbertson.* This is a situation which this Court should not allow to occur, because it will undermine the laudable goal of uniformity which the Courts of Appeals have been working to achieve.

Recently, Justice O'Connor in *Teague v. Lane,* 489 U.S. 288, 109 S.Ct. 1060, 103 L.Ed.2d 334 (1989), citing Miskin, *Forward: The High Court, The Great Writ, and The Due Process of Time and Law,* 79 Harv. L. Rev. 56, 64 (1965), said:

> In our view, the question 'of whether a decision [announcing a new rule should] be given prospective or retroactive effect should be faced at the time of [that] decision' . . . Retroactivity is properly treated as a threshold question, for, once a new rule is applied to the defendant in the case announcing the rule, evenhanded justice requires that it be applied retroactively to all who are similarly situated.

489 U.S. at 300, 109 S.Ct. at 1069, 103 L.Ed.2d at 349. The foregoing principle notwithstanding, Justice O'Connor recognized that the Court often applied a new rule of law in the case which announced it, and confronted the issue of retroactivity in a later case. 489 U.S. at 299, 109 S.Ct. at 1069, 103 L.Ed.2d at 348.

If this Court decides *Lampf, Plena, Lipkind, Prupis & Petigrow v. Gilbertson* in such a way as to adopt a uniform federal period of limitations for actions under §10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, this case should be reviewed so that the split among the Second and Third Circuits relating to retroactivity which presently exists can be resolved as quickly as possible. For this reason, petitioners respectfully request that this Petition for Writ of Certiorari be granted.

Respectfully submitted,

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APPENDIX

Opinion of the United States Court of Appeals for the Second Circuit Dated January 22, 1991

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[989] Dr. William WELCH III, Dr. Andrew Guest, and Mrs. Elizabeth Guest, Plaintiffs-Appellants,

v.

CADRE CAPITAL, R. Laken Mitchell, Esq., John Roberts, Edna Lou Ballard, Norman Ballard, Financial Centre Securities, Northwest Mutual, a Savings Institution, Defendants-Appellees,

Mutual Fire & Marine Inland Insurance Company, Defendant.

No. 263, Docket 90-7419.

United States Court of Appeals, Second Circuit.

Argued Sept. 26, 1990.
Decided Jan. 22, 1991.

Investors brought action alleging fraud in interests purchased from limited partnership. The United States District Court, District of Connecticut, Alan H. Nevas, J., 735 F.Supp. 467, dismissed. Investors appealed. The Court of Appeals, Jon O. Newman, Circuit Judge, held

that Second Circuit ruling abandoning practice of applying analogous state statutes of limitations to actions brought under §10(b) of the Securities and Exchange Act and opting for uniform federal limitations period was not retroactively applicable.

Reversed and remanded.

1. **Federal Courts** 659

While appellant failed to notice appeal from final judgment dismissing all claims, appeal could be entertained on basis of premature notice of appeal from order dismissing federal claims on limitations grounds, but leaving pendent state claims for dismissal; trial court judge had made clear that he would dismiss state law counts if federal claims were found to be time barred.

2. **Federal Courts** 668

Rule of appellate procedure which treats notice of appeal filed after announce-[990] ment but before entry of order as if it had been filed after such entry and on date thereof applies only to order that is final. F.R.A.P. Rule 4(a)(2), 28 U.S.C.A.

3. **Federal Courts** 659

Under circumstances, it would be inequitable to permit appellees to obtain dismissal of premature appeal after time for filing notice of appeal from final judgment had expired; appellees could have moved to dismiss premature appeal at any time prior to entry of final judgment.

4. **Federal Courts** 924

Appellant's failure to raise issue of whether newly announced limitations period applicable to §10(b) and Rule 10b-5 claims was retroactively applicable did not preclude Court of Appeals from considering issue, particularly as case announcing new rule was decided after appeal was heard. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(e).

5. **Courts** 100(1)

Proponent of prospectively-only application of decision announcing new rule of limitations need not satisfy all three *Chevron* factors.

6. **Courts** 100(1)

Second Circuit ruling abandoning practice of applying analogous state statutes of limitations to actions brought under §10(b) of the Securities and Exchange Act and opting for uniform federal limitations period was not retroactively applicable. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(e).

7. **Federal Courts** 939

Proper time and place for raising assertion that securities plaintiffs failed to plead element of "substantial assistance" with sufficient specificity to support 10b-5 aiding and abetting claim was on remand before district court where plaintiffs, if need be, could be afforded opportunity to replead. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(e).

Peter Luria, West Hartford, Conn., for plaintiffs-appellants.

Alexandra Davis, Hartford, Conn. (Kimberly A. Knox, Moller, Horton & Fineberg, and Antoinette L. Ruzzier, Hartford, Conn., on the brief), for defendants-appellees Roberts, Edna Lou Ballard, Norman Ballard, and Financial Centre Securities.

Russell J. Ober, Jr., Pittsburgh, Pa. (Steven Petrikis, Rose Schmidt Hasley & DiSalle, Pittsburgh, Pa. and Robert L. Wyld, Linda L. Yoder, Shipman & Goodwin, Hartford, Conn., on the brief), for defendant-appellee Northwest Sav. Bank.

J. Jeffrey Coughlin, Bridgeport, Conn. (Bai, Pollock & Dunnigan, Bridgeport, Conn., on the brief), for defendant-appellee Cadre Capital.

Before NEWMAN, PIERCE, and ALTIMARI, Circuit Judges.

JON O. NEWMAN, Circuit Judge:

In *Ceres Partners v. GEL Associates*, 918 F.2d 349 (2d Cir. 1990), we abandoned the practice of applying analogous state statutes of limitations to actions brought under section 10(b) of the Securities and Exchange Act of 1934; 15 U.S.C. §78j(b), and rule 10b-5, 17 C.F.R. §240.10b-5 (1990). Following intimations from the Supreme Court, *see Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1987), we opted for a uniform federal limitations period and selected the limits specified in sections 9(e) and 18(c) of the '34 Act, 15 U.S.C. §§78i(e), 78r(c)—one year from discovery of the violation and three years from the violation. The issue in the pending appeal is whether the new limitations rule of *Ceres* should be applied retroactively, an issue *Ceres* did not resolve.

The issue arises on an appeal by William Welch and Andrew and Elizabeth Guest from the April 12, 1990, order of the District Court for the District of Connecticut (Alan H. Nevas, Judge) granting a motion to dismiss their '34 Act claims against a group of eight defendants allegedly responsible for defrauding plaintiffs into buying and maintaining limited partnership shares in an ill-fated oil and gas drilling venture. *Welch v. Cadre Capital*, 735 F.Supp. 467, [991] 476 (D.Conn. 1989). Judge Nevas found plaintiffs' '34 Act claims time-barred under the federal limitations period this Circuit adopted in *Ceres*, decided after his decision. We conclude that this case falls within the exception to the general practice of applying new judicial decisions retroactively. We therefore reverse and remand.

BACKGROUND

The complaint alleges the following facts as grounds for plaintiffs' '34 Act claims. William Welch and Andrew and Elizabeth Guest each purchased limited partnerhsip interests in the Keystone 84-1 Oil and Gas Drilling Program. The Keystone Program, for which defendant Cadre Capital served as managing general partner, involved a venture to drill at least six oil and gas wells. To become limited partners, Welch and the Guests were required to purchase one or more discrete interests in Keystone; the price for each interest was a $5,000 cash payment and execution of a $15,000 promissory note. The guests purchased six limited partnership interests on May 10, 1984, based on representations made by defendants Edna Lou and Norman Ballard, acting on behalf of defendant Financial Centre Securities. On May 25, 1984, Welch purchased two limited partnership interests on the recommendation of defendant John Roberts, then a registered broker with Financial Centre

Securities. In July of 1984, defendant R. Laken Mitchell, counsel for the general partnership, informed Welch and the Guests that their notes had been assigned to defendant Northwest Savings Bank as collateral for loans used to finance drilling operations. Defendant Mutual Fire & Marine Inland Insurance Company guaranteed payment of the assigned notes on behalf of the general partnership.

Welch and the Guests first learned of Keystone's demise in early 1987. Welch heard of Keystone's "financial difficulties" from defendant Roberts in January 1987. The Guests remained unaware until March 1987 when Financial Centre Securities informed them of Keystone's insolvency. Welch and the Guets subsequently brought suit on October 17, 1988, in the District Court for the District of Connecticut. The first two counts of their six-count complaint alleged violations of the mandatory registration provisions of the 1933 Securities Act, §5(a), (c), 15 U.S.C. §77e(a), (c), and the anti-fraud provisions of the '33 Act, §§12, 17, 15 U.S.C. §§77*l* and 77q(a), and section 10(b) of the 1934 Securities and Exchange Act, 15 U.S.C. §78j(b) and rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder. In addition to suing for primary violations of the '34 Act, the plaintiffs also alleged that Northwest Savings Bank and Mutual Fire & Marine Inland Insurance Company aided and abetted the commission of securities fraud by the other defendants. The other four counts sought relief for violations of the anti-fraud provision of the Connecticut Uniform Securities Act, Conn.Gen.Stat. §36-498 (1989), common law fraud, breach of fiduciary duty, and negligent misrepresentation.

By order dated August 17, 1989, Judge Nevas granted defendants' motion to dismiss the '33 Act claims. *See Welch v. Cadre Capital*, 735 F.Supp. 467 (D.Conn. 1989).

Deferring decision on the '34 Act claims, Judge Nevas informed the parties that he would decline to exercise jurisdiction over the pendent state law counts should the '34 Act claims later be dismissed. *Id.* at 476. In a subsequent decision, Judge Nevas anticipated this Circuit's decision in *Ceres* and adopted the one-year/three-year limitations period. *Id.* at 476-77. He then ruled that the new limitations period should be applied retroactively in this case. Since appellants filed their suit more than one year after discovery of the alleged fraud, the '34 Act claims were dismissed in an order dated April 12, 1990. With all federal claims dismissed, Judge Nevas then dismissed without prejudice the pendent state law counts on May 24. Judgment was entered on May 25. Without awaiting entry of judgment, appellants filed on May 2, 1990, a notice of appeal from the April 12th order.

DISCUSSION

I. Appellate Jurisdiction

[1] Initially, we must determine our appellate jurisdiction, which is called into [992] question by the appellants' failure to notice an appeal from the final judgment dismissing all claims. Prior to oral argument, we invited the parties to consider whether the appeal could be entertained on the basis of the premature notice of appeal from the April 12 order dismissing the federal claims, but leaving the pendent state law claims for dismissal a month later.

[2,3] On prior occasions we have indicated that a premature notice of appeal from a nonfinal order may ripen into a valid notice of appeal if a final judgment has been entered by the time the appeal is heard and the appellee suffers no prejudice. *See Festa v. Local 3,*

International Brotherhood of Electrical Workers, 905 F.2d 35, 36-37 (2d Cir.1990); *Schlehan v. Olympic Worldwide Communications, Inc.*, 763 F.2d 135, 138 (2d Cir.1985); *Pireno v. New York State Chiropractic Association*, 650 F.2d 387, 389-90 n. 4 (2d Cir.1981), *aff'd on other grounds sub nom. Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 102 S.Ct. 3002, 73 L.Ed.2d 647 (1982); *cf. Matarese v. LeFevre*, 801 F.2d 98, 104-06 (2d Cir.1986) (premature appeal of order, subsequently entered, denying rule 60(b) motion), *cert. denied*, 480 U.S. 908, 107 S.Ct. 1353, 94 L.Ed.2d 523 (1987).[1] Though there may be limits upon our willingness to permit a premature notice of appeal to "ripen" after entry of a final judgment, *see* 16 C. Wright, A. Miller, E. Cooper, *Federal Practice and Procedure* §3950, at 392 (Supp.1990), it is appropriate to entertain jurisdiction in this case.[2] Judge Nevas made clear in the August 17,

[1] This approach appears to have originated with *Yaretsky v. Blum*, 592 F.2d 65, 66 (2d Cir.1979) ("[T]he better rule is that in the absence of prejudice to the appellee, the court should treat a premature appeal as from a final judgment so as to avoid denial of justice, expense, and inconvenience."). Since the premature notice of appeal in *Yaretsky* was filed during pendency of a Rule 59(e) motion, the holding of *Yaretsky* has been superseded by Fed.R.App.P. 4(a)(4), as the Supreme Court subsequently noted. *See Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56, 59, 103 S.Ct. 400, 402, 74 L.Ed.2d 225 (1982). Nevertheless, the philosophy of *Yaretsky*, tolerating a premature notice of appeal, remains valid so long as the notice is not nullified under Fed.R.App.P. 4(a)(4), as our decisions in *Festa*, *Schlehan*, and *Pireno* recognize.

[2] Though we are willing to accept appellate jurisdiction despite the prematurity of the notice of appeal, we do not rest decision upon Fed.R.App.P. 4(a)(2), which treats a notice of appeal filed after announcement but before entry of an order as it if had been filed "after such entry and on the day thereof." That provision applies only to an order that is final. *See Marsh-McBirney, Inc. v. Montedoro-Whitney Corp.*, 882 F.2d 498, 503 (Fed.Cir.1989); *United States v. Hansen*, 795 F.2d 35, 37 (7th Cir.1986); 9 *Moore's Federal Practice* ¶204.14, at 4-128 (2d ed. 1990). It is the entry of the final judgment dismissing all claims, not the entry of the April 12 order dismissing the '34 Act claims, that permits us to entertain the appeal.

1989, order disposing of the '33 Act claims that he would exercise his discretion to dismiss the state law counts if the '34 Act counts were later found to be time-barred. In light of this clearly-expressed intention, the order of April 12, 1990, granting defendants' motion to dismiss the '34 Act claims, effectively signaled the end of the case. Appellees are not prejudiced by our accepting jurisdiction based on the premature notice of appeal, now that a final judgment has been entered.[3]

II. Retroactivity of *Ceres*

[4] In *Ceres* this Circuit replaced the longstanding practice of borrowing the most analogous state statute of limitations for claims founded on section 10(b) of the '34 Act and rule 10b-5 with the limitations periods statutorily prescribed for private causes of action expressly provided by the '34 Act. *See* 15 U.S.C. §§78i(e) and 78r(c). First adopted by the Third Circuit, *see In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.) (in banc), *cert.denied*, 488 U.S. 849, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988), and more recently by the Seventh Circuit, *see Short v. Belleville Shoe Manufacturing Co.*, 908 F.2d 1385 (7th Cir.1990), this "one-year/three-year" formulation bars any suit [993] filed more than one year after discovery of the fraud or more than three years after the violation. The Third Circuit has applied the federal limitations period retroactively, *Hill v. Equitable Trust Co.*, 851 F.2d 691 (3d Cir.1988), *cert. denied*, 488 U.S. 1008, 109 S.Ct. 791, 102 L.Ed.2d 782 (1989), although the ruling had no adverse consequence for the plaintiffs since their claims would have been barred under the equivalent limitations

[3] Appellees could have moved to dismiss the premature appeal at any time prior to entry of final judgment. In the circumstances of this case, it would be inequitable to permit them to obtain a dismissal of the premature appeal now that the time for filing a notice of appeal from the final judgment has expired.

period of applicable state law. Like the Seventh Circuit, *see Short,* 908 F.2d at 1390; *Robin v. Arthur Young & Co.,* 915 F.2d 1120, 1123 (7th Cir.1990), we have yet to pass on the question. Because plaintiff's 10b-5 claims were properly dismissed under either approach, the panel in *Ceres* was not faced with and expressly left unresolved the retroactive application of the "one-year/three-year" limitations period. *See Ceres,* 918 F.2d at 364. The pending case squarely presents the issue left unresolved in *Ceres.*[4] Under the traditional borrowing approach, we would look to the law of Connecticut as the forum state to determine the limitations period, *see Armstrong v. McAlpin,* 699 F.2d 79, 86-87 (2d Cir.1983), and to federal law for guidance as to the appropriate equitable tolling principle. *See, IIT, An International Investment Trust v. Cornfeld,* 619 F.2d 909, 929 (2d Cir.1980). Federal courts in Connecticut have long considered the most appropriate limitations period for 10b-5 claims to be that found in the Connecticut Uniform Securities Act, which proscribes the bringing of suit "more than two years after the contract of sale." Conn.Gen.Stat. §36-498(f) (1989); *Clute v. Davenport Co.,* 584 F.Supp. 1562, 1577 (D.Conn.1984); *Dandorph v. Fahnestock & Co.,* 462 F.Supp. 961, 963 n. 4 (D.Conn.1979); *Hitchcock v. deBruyne,* 377 F.Supp. 1403 (D.Conn.1974). Though application of this provision alone would bar the instant suit, the plaintiffs are entitled, by virtue of their allegations of active concealment of fraud, to tolling of the limitations period until their discovery of the fraud in 1987. *See Baskin v. Hawley,* 807 F.2d 1120, 1130-31 (2d

[4] The appellant's failure to raise the issue of retroactivity does not preclude this Court from considering the issue. *See Teague v. Lane,* 489 U.S. 288, 300, 109 S.Ct. 1060, 1069, 103 L.Ed.2d 334 (1989) (plurality opinion). Such consideration is especially appropriate since *Ceres* was decided not only after the complaint was filed, but after this appeal was heard.

Cir.1986); *Robertson v. Seidman & Seidman*, 609 F.2d 583, 593 (2d Cir.1979). Thus, under prior law, their commencement of suit in October of 1988 would be timely. Under the newly-adopted "one-year/three-year" rule, the plaintiffs would have been obliged to bring suit in March of 1988 at the latest, one year after the Guests' discovery of the alleged fraud.

We look to the three-part test set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971), to determine whether this rule should be applied retroactively to bar the plaintiffs' '34 Act claims. *Chevron* recognized for civil actions a narrow exception to the general presumption favoring application of the law prevailing at the time of appeal. *See Goodman v. Lukens Steel Co.*, 482 U.S. 656, 662, 10 S.Ct. 2617, 2621, 96 L.Ed.2d 572 (1987); *Gonzalez v. Home Insurance Co.*, 909 F.2d 716, 723 (2d Cir.1990). To qualify for purely prospective application, a decision "must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." *Chevron*, 404 U.S. at 106, 92 S.Ct. at 355.[5] A court should then "weigh" in each case whether retroactive application would conflict with the purposes of the rule and whether it would produce inequitable results.[6] *Id.* at 106-07, 92 S.Ct. at 355-56.

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[5] It is worth emphasizing that the first prong of the *Chevron* test requires only a prior rule on which plaintiff's "may" have relied, and does not create a test of actual reliance.

[6] Whether *Chevron* retains validity for issues of retroactivity outside the context of statutes of limitations has been placed in doubt by *American Trucking Associations, Inc. v. Smith*, _____ U.S. _____, 110 S.Ct. 2323, 110 L.Ed.2d 148 (1990), in which one Justice appears to reject *Chevron* altogether, *id.* 110 S.Ct. at 2343 (Scalia, J., concurring in the judgment), and four Justices appear to regard it as controlling only as to federal court remedies, *id.* at 2345, 2352-55 (Stevens, J., with whom Brennan, Marshall, and Blackmun, JJ., join, dissenting).

[5] An initial issue in applying *Chevron* is whether the proponent of a prospective-[994] only application must satisfy all three of the *Chevron* factors. Judge Nevas read our decisions in *Kremer v. Chemical Construction Corp.*, 623 F.2d 786 (2d Cir.1980), *aff'd on other grounds*, 456 U.S. 461, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982), and *Holzsager v. Valley Hospital*, 646 F.2d 792 (2d Cir.1981), as requiring that the proponent do so. *Welch v. Cadre Capital*, 735 F.Supp. at 482. We disagree. What *Kremer* makes clear is that the first factor is mandatory. "[U]nless the first factor is satisfied, there is no occasion to consider the other two." *Kremer*, 623 F.2d at 789. If the proponent of nonretroactivity clears the first hurdle, the court then proceeds to the "balancing process demanded by the second and third factors." *Id.* A "balancing process" does not require that all relevant factors be established. *Holzsager* merely pointed out that the three *Chevron* factors would "inform" the decision as to retroactivity. *Holzsager*, 646 F.2d at 797.

[6] Examining the first *Chevron* factor, we conclude that *Ceres*, which overrules well-established precedent, meets the threshold requirement for nonretroactive application. Adoption of a uniform federal limitations period changes the practice in this Circuit, which was clear at the time the alleged fraud was discovered, of looking to the law of the forum state for an appropriate statute of limitations for 10b-5 claims. In Connecticut, as we have noted, every court to have considered the issue has ruled that this entails combining the two-year limitations period in the Connecticut Uniform Securities Act with the federal equitable tolling doctrine. Though some of the Supreme Court decisions forming the doctrinal foundation for *Ceres*' rejection of the borrowing approach had already been decided by 1987, around the time plaintiffs discovered the alleged fraud, *see Agency*

Holding Corp. v. Malley-Duff & Associates, Inc., supra; Wilson v. Garcia, 471 U.S. 261, 105 S.Ct. 1938, 85 L.Ed.2d 254 (1985); *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151 (1983), the impending revision of a limitations period for 10b-5 claims was not so clearly foreshadowed that plaintiffs were chargeable with its prediction.

Application of the second *Chevron* factor—effect of retroactive application upon the rule in question—is more problematical. Though *Chevron* concerned the retroactivity of a limitations ruling, the issue arose in a context quite different from the one we face here. In *Chevron* the new limitations standard was the one-year period of state law, rather than the prior, more indeterminate laches standard of admiralty law. The new standard was applicable by virtue of the Supreme Court's decision in *Rodrigue v. Aetna Casualty & Surety Co.*, 395 U.S. 352, 89 S.Ct. 1835, 23 L.Ed.2d 360 (1969), which held that injuries at locations such as that involved in *Chevron* were governed by state law under the Court's new interpretation of the Outer Continental Shelf Lands Act, 43 U.S.C. §1331 *et seq.* (1988) ("the Lands Act"). When the Court inquired as to whether retroactivity would aid or hinder "the rule in question," *Chevron*, 404 U.S. at 107, 92 S.Ct. at 355, it focused, not on the new rule of limitations, but on the new rule, announced in *Rodrigue*, of absorbing state law as federal law under the Lands Act, *id.* at 107-08, 92 S.Ct. at 355-56. The purpose of that rule was to aid injured employees by affording comprehensive remedies, a purpose that would have been impaired by retroactive application of a new and shorter limitations period.

Obviously, if "the rule in question" is the new limitations period itself, its retroactive application will always further the new rule: A new, shorter period will

end a law suit filed beyond the new limits, and a new, longer period will allow a lawsuit otherwise barred. We doubt if the Court in *Chevron* contemplated such a mechanical inquiry. Some indication that it did not arises from the fact that the text quoted in *Chevron* to articulate the second factor is from *Linkletter v. Walker*, 381 U.S. 618, 629, 85 S.Ct. 1731, 1737, 14 L.Ed.2d 601 (1965). *Linkletter* held that the exclusionary rule of *Mapp v. Ohio*, 367 U.S. 643, 81 S.Ct. 1684, 6 L.Ed.2d 1081 (1961), would not be applied retroactively because the deterrent effect of *Mapp* could not be achieved as to police conduct occurring prior to decision in that case. *See Linkletter*, 381 U.S. at 637, 85 S.Ct. at 1742, *see also American Trucking* [995] *Associations, Inc. v. Smith*, _____ U.S. _____, 110 S.Ct. 2323, 2332, 110 L.Ed.2d 148 (1990) (plurality opinion) (applying second *Chevron* factor by examining purpose of the Commerce Clause, which provided the rationale for the particular rule whose retroactivity was at issue).

In the pending case, the application of a new and shorter limitations period (one year after discovery of the fraud) cannot affect the conduct of the plaintiffs where the new rule is announced after expiration of that period. As with all statutes of repose, the one-year/three-year limitations period advances the remedial and deterrent purposes of the particular cause of action and preserves the defendant's interest in repose by simultaneously giving notice to potential plaintiffs of the time within which suit must commence and to potential defendants of the time beyond which exposure to liability ceases. Because they serve primarily individual, rather than institutional, interests and do so by giving potential litigants prior notice of their rights, application of a limitations period not yet in existence at the time suit

was commenced clearly does not further either of the competing interests. The second *Chevron* inquiry thus favors a different result in this case than in *Kremer*, 623 F.2d at 790, and *Gargiul v. Tompkins*, 790 F.2d 265, 274 (2d Cir.1986), in which the purpose furthered by the new rule under consideration, the institutional interest in federal and state court comity, was equally well served regardless of whether litigants had received prior notice. Moreover, we do not agree with Judge Nevas that permitting plaintiffs' suit to be maintained will "frustrate" the "schema of the 1934 Act." 735 F.Supp. at 484. The purposes of the '34 Act will not be impaired by continuation of a handful of lawsuits filed within the longer time limits of previously applicable state law.

As to the third *Chevron* factor, we believe the equities favor the plaintiffs. Taking plaintiffs' allegations as true at this stage of the litigation, defendants' active concealment of fraud, rather than anything attributable to the plaintiffs, caused the initial three-year delay between violation and discovery of the fraud. And unlike the twenty-month delay in *Holzsager*, the subsequent one-and-a-half year delay was not the result of precedural maneuvering designed to achieve a tactical advantage. Though, as Judge Nevas pointed out, plaintiffs, in not filing suit promptly after discovery of the fraud, could not be certain that a court would subsequently agree with their assertion as to the interval of equitable tolling, we see no reason in this case to fault them for taking most of the then applicable two-year period after discovery of alleged fraud to determine whether they had grounds for suit. Accordingly, retroactive application of the rule in *Ceres* would unjustly deny plaintiffs' "right to a day in court." *Chevron*, 404 U.S. at 108, 92 S.Ct. at 356.

[7] Defendant Northwest Savings Bank presents as an alternative ground for affirming the District Court's dismissal of the 10b-5 aiding and abetting claim plaintiffs' failure to plead with specificity the element of "substantial assistance." *See National Union Fire Insurance Co v. Turtur,* 892 F.2d 199, 206-07 (2d Cir.1989). The proper time and place for raising this point is on remand before the District Court where, if need be, plaintiffs can be afforded an opportunity to replead.

The judgment of the District Court is reversed, and the case is remanded.

Judgment of the United States Court of Appeals for the Second Circuit Dated January 22, 1991

CONN.
H88-cv-717
NEVAS

MANDATE

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 22nd day of January, one thousand nine hundred and ninety-one.

Present: HON. JON O. NEWMAN
HON. LAWRENCE W. PIERCE
HON. FRANK X. ALTIMARI
Circuit Judges,

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT
FILED
JAN 22 1991
ELAINE B. GOLDSMITH, CLERK

Docket No. 90-7419

DR. WILLIAM WELCH III, DR. ANDREW GUEST, and MRS. ELIZABETH GUEST,
Plaintiffs-Appellants,

-v-

CADRE CAPITAL, R. LAKEN MICHELL, ESQ. JOHN ROBERTS, EDNA LOU BALLARD, NORMAN BALLARD, FINANCIAL CENTRE SECURITIES, NORTH WEST MUTUAL, A SAVINGS INSTITUTION,
Defendants-Appellees.

MUTUAL FIRE & MARINE INLAND
INSURANCE COMPANY,

Defendant.

Appeal from the United States District Court for the Connecticut District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Connecticut District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the appeal from the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to the said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

Elaine B. Goldsmith, Clerk
By:
EDWARD J. GUARDARO
Edward J. Guardaro
Deputy Clerk

A TRUE COPY
ELAINE B. GOLDSMITH, Clerk
By (ILLEGIBLE)
Chief Deputy Clerk

ISSUED AS MANDATE: February 26, 1991

Opinion of the United States District Court for the District of Connecticut Dated April 12, 1990

[467] WELCH v. CADRE CAPITAL
Cite as 735 F.Supp. 467 (D.Conn. 1989)

Dr. William WELCH, III, et al.

v.

CADRE CAPITAL, et al.

Civ. No. H-88-717(AHN).

United States District Court,
D. Connecticut.

Aug. 18, 1989.

Opinion on Motion to Dismiss §10(b) and Rule 10b-5 Actions April 12, 1990.

Investors brought action alleging fraud in interests purchased from limited partnership. The District Court, Nevas, J., held that proper statute of limitations for fraud claims under Securities Exchange Act §10(b) and Rule 10b-5 was one year after plaintiff discovered fact giving rise to violation, and not later than three years after violation, which was statute of limitations applicable to other private rights of action under Act.

Motion to dismiss granted.

1. **Securities Regulation** 134

Limitation period of three years for bringing claim under section of Securities Act creating private cause of action for violations of section prohibiting sale or delivery of unregistered securities in interstate commerce was absolute bar to bringing case outside three years,

even if fraudulent conduct was actively concealed. Securities Act of 1933, §§12, 12(1, 2), 13, 17, 17(a), 15 U.S.C.A. §§77*l*, 77*l*(1, 2), 77m, 77q, 77q(a).

2. Securities Regulation 27.27

No private cause of action lies under the Securities Act section prohibiting fraudulent offer or sale of securities in interstate commerce. Securities Act of 1933, §17(a), 15 U.S.C.A. §77q(a).

3. Securities Regulation 134

Even though federal court turns to state law for reference to limitation period on claims under section of Securities Exchange Act governing buyers' remedies, it is federal law which determines when period begins to run. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b); C.G.S.A. §36-498(f).

4. Limitation of Actions 100(6)

Limitations period for claims under Securities Exchange Act section governing buyers' remedies does not commence at time of sale of security but begins when plaintiff has actual knowledge of alleged fraud or knowledge of facts which should have led to knowledge of fraud. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b); C.G.S.A. §36-498(f).

5. Limitation of Actions 104(2)

Equitable tolling, for claim of passive concealment, of Securities Exchange Act section governing buyers' remedies requires showing of both concealment and use of due diligence by plaintiff to discover fraud; if

concealment is active, due dil-[468] igence is irrelevant. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b); C.G.S.A. §36-498(f).

On Motion to Dismiss §10(b) and Rule 10b-5 Actions

6. Securities Regulation 134

Proper limitations period for claims arising under buyers' remedy section of Securities Exchange Act of 1934 is limitations period applicable to other private rights of action under Act, which is one year after plaintiff discovers fact constituting violation, and in no event later than three years after such violation. Securities Exchange Act of 1934, §§9(e), 10(b), 20(a), 15 U.S.C.A. §§78i(e), 78j(b), 78t(a).

7. Federal Courts 424

Characterization of federal claim for purposes of selecting appropriate statute of limitations is generally question of federal law.

8. Limitation of Actions 138

Plaintiffs who waited more than one and one-half years after discovering fraud in sale of securities, which discovery occurred three years after purchase, failed to show that reliance on federal law determination rather than state law determination of when limitation period began to run was reasonable. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

9. Courts 100(1)

Court decision to apply federal law to limitations period for actions alleging securities fraud would not apply retroactively. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

Peter Luria, West Hartford, Conn., for plaintiffs.

Jeffrey A. Blueweiss, Bai, Pollock & Dunnigan, Bridgeport, Conn., for defendant Cadre Capital.

R. Laken Mitchell, Nashville, Tenn., for defendant R. Laken Mitchell, Esq.

Antoinette Leone Ruzzier, Ward, Sevarino & Ruzzier, Hartford, Conn., for defendants John Roberts, Ednalou Ballard, Norman Ballard and Financial Center Securities.

Russell J. Ober, Rose Schmidt, Hasley & DiSalle, Pittsburgh, Pa., for defendant Northwest Mut. Sav. Ass'n.

Linda Karter, Schatz & Schatz, Ribicoff & Kotkin, Hartford, Conn., for defendant Mutual Fire & Marine Inland Ins. Co.

PARTIAL RULING ON PENDING MOTIONS TO DISMISS

NEVAS. District Judge.

The three plaintiffs in this case alleging investment fraud purchased interests in May 1984 in a limited partnership known as the "Keystone 84-1 Oil and Gas Drilling Partnership" ("Keystone"). In their six-count complaint, the plaintiffs allege violations of several federal securities statutes, a Connecticut securities statute, and common law. They have sued eight defendants purportedly either directly or peripherally associated with Keystone. Pending are motions to dismiss filed by six defendants; the motions raise a host of challenges to the complaint and are brought under Rules 9(b) and 12(b)(6), Fed.R.Civ.P. For the following reasons, the defendants' motions are granted in part. The court dismisses the plaintiffs' causes of action brought

under the Securities Act of 1933 ("1933 Act"), 15 U.S.C. Section 77a *et seq.* As noted *infra, see* section II.A.2, the court requests further briefing on an issue relating to the plaintiffs' cause of action brought pursuant to the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. Section 78a *et seq.* Until that issue is resolved, the court reserves decision on the remaining challenges to the complaint.

I. *Background*

A. *Factual*

The well-pleaded allegations of the complaint support the following story line: After being contacted by plaintiff Dr. William Welch in the spring of 1984, defendant John Roberts, a broker with defendant Financial Center Securities ("FCS") of Farmington, Connecticut, recommended Keystone to Welch as an investment opportuni-[469] ty.[1] Keystone involved the drilling of six oil and gas wells. Limited partners in Keystone could subscribe in units of $20,000 each—$5,000 down in cash and $15,000 from an interest-bearing promissory note. Total capital contributions from limited partners were to range from $880,000 to $1,760,000. On May 25, 1984 Welch met with Roberts and purchased two units in Keystone, executing two promissory notes totalling $30,000. By July of the same year, Welch had paid the necessary $10,000 cash.

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[1] In deciding Rule 12(b)(6) aspects of this case, the court accepts as true all well-pleaded factual allegations set forth in the complaint, *see Miree v. DeKalb County,* 433 U.S. 25, 27 n. 2, 97 S.Ct. 2490, 2492 n. 2, 53 L.Ed.2d 557 (1977), and construes these allegations in a light most favorable to the non-moving parties. *Scheuer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 1686, 40 L.Ed.2d 90 (1974).

Under the terms of the Keystone program, its general partners could assign the investors' promissory notes to lending institutions as security for loans made in Keystone to finance drilling operations. Defendant Cadre Capital was the managing general partner for Keystone. On July 24, 1984 defendant R. Laken Mitchell, the attorney for the general partnership, notified Welch by letter that his two notes had been assigned to Northwest Mutual Savings Association, now defendant Northwest Savings Bank ("Northwest"), as security for a Keystone loan. At about that time defendant Mutual Fire and Marine Inland Insurance Company ("Mutual Fire") issued a surety bond on behalf of Keystone's general partners guaranteeing Northwest payment of the plaintiff's notes.

Also in May 1984, defendants Ednalou and Norman Ballard, principals in FCS, solicited plaintiffs Dr. Andrew Guest and his wife, Elizabeth, for a series of financial seminars. After attending these seminars, the Guests were induced to purchase six limited partnerships in Keystone. On May 10, 1984 they paid $30,000 cash for these units and executed a promissory note for $90,000. On the same day that he wrote to Welch, Attorney Mitchell notified the Guests that their note had also been assigned to Northwest. As it had for the Welch transaction, Mutual Fire provided a surety bond pledging payment of the Guests' note.

In May 1985 Welch contacted Roberts about inadequate status reports on the drilling operations. FCS represented that it had retained an outside advisor to evaluate Keystone: the advisor produced a report, dated October 15, 1985 and forwarded to the plaintiffs on November 4, 1985, which concluded that Keystone was being properly operated. Also in May 1985 Welch

inquired of Roberts and FCS about the possibility of refinancing his promissory notes at a lower interest rate. A Keystone general partner, Commonwealth Enterprises, Inc. ("Commonwealth"), told Welch that his subscription funds had been placed in interest-bearing escrow accounts and that refinancing would not then be economically sound.

FCS wrote the plaintiffs on May 14, 1986 to inform them of a second outside evaluation of Keystone. FCS told the plaintiffs that it would update them as soon as FCS received a report. On June 3, 1986 the Guests received a letter from a Keystone general partner reassuring them of the soundness of the program. In January 1987 Roberts informed Welch that Keystone was suffering financial difficulties. Two months later the Guests received word from FCS that Keystone was insolvent and Commonwealth bankrupt.

B. *Causes of Action*

The plaintiffs brought suit on October 17, 1988. Count one of the complaint alleges violations of sections 5(a) and (c) of the 1933 Act, 15 U.S.C. Section 77e(a) & (c). According to the complaint, the defendants never registered the security interests in Keystone with the Securities and Exchange Commission ("SEC").

Count two invokes the anti-fraud provisions of the 1933 Act—sections 12 and 17, codified at 15 U.S.C. Sections 77*l* and 77q(a), respectively—and section 10(b) of the 1934 Act, 15 U.S.C. Section 78j(b), and Rule 10b-5 promulgated thereunder, 17 [470] C.F.R. Section 204.10b-5. From May 1985, according to the plaintiffs, the defendants have defrauded them about Keystone. The fraudulent scheme has allegedly included dissemination of false and misleading information, both oral and

written, about the suitability of limited partnership interests in Keystone. The documents provided the plaintiffs failed to disclose, among other things, prior litigation by the SEC against John Meatte, the president of Commonwealth, fiduciary conflicts of interest among the general partners in Keystone, and the diversion of Keystone monies for the private use of Meatte and Commonwealth. According to the complaint, at the times of their initial contacts with the plaintiffs, Roberts, the Ballards, and FCS knew of Meatee's litigation history and chose not to reveal it. Defendant Mitchell, the attorney, prepared a "Private Placement Memorandum" for Keystone; the document omitted mention of Meatte's litigation history and the plaintiffs relied on the memorandum to their detriments. At some unspecific time before the sales of the Keystone units to the plaintiffs, Northwest and Mutual Fire purportedly performed their own investigations into Keystone, discovered or should have discovered Meatte's troubled past, and withheld the information from the plaintiffs.

As to the remaining four counts the plaintiffs invoke the count's pendent jurisdiction over their state law claims. In count three the plaintiffs allege violations of the anti-fraud provision of the Connecticut Uniform Securities Act ("CUSA"), Conn.Gen.Stat. Section 36-498. The alleged misrepresentations and omissions underlying count two also support the CUSA cause of action, according to the plaintiffs. Counts four, five, and six hinge on common law fraud, breach of fiduciary duty, and negligent misrepresentation, respectively.

II. *Discussion*

Motions to dismiss have been filed by all defendants except Mitchell and Mutual Fire. The motions raise sundry challenges, some specific to an individual

defendant, others common to all defendants. In this partial ruling on the motions to dismiss, the court addresses the following challenges to the complaint.

A. *Federal Causes of Action*

1. 1933 Act

The complaint alleges violations of three sections of the 1933 Act: section 5 (count one); section 12 (count two); and section 17(a)(count two). Section 5 prohibits a person or entity from selling or delivering unregistered securities in interstate commerce. *See* 15 U.S.C. Section 77e. Section 12(1) of the 1933 Act creates a private cause of action for section 5 violations. Under section 12(1), aggrieved holders of unregistered securities may rescind the transactions and recover the consideration paid for the securities or, if the securities have been sold to third parties, may recover damages. *See id.* Section 77*l*(1). Section 12(2) permits a cause of action for the fraudulent sale of securities in interstate commerce. *See id.* Section 77*l*(2). Section 17(a) also prohibits the fraudulent offer or sale of securities in interstate commerce. *See id.* Section 77q(a).

Causes of action brought pursuant to sections 12(1) and (2) are governed by the statute of limitations set forth in section 13 of the 1933 Act, which states in relevant part:

> No action shall be maintained to enforce any liability created under section . . . [12(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section [12(1)] of this title, unless brought within one year after the violation upon which it is based. In no event shall

> any such action be brought to enforce a liability created under section . . . [12(1)] of this title more than three years after the security was bona fide offered to the public, or under section [12(2)] of this title more than three years after the sale.

Id. Section 77m. By the defendants' reckoning, the Keystone securities underlying this suit were bona fide offered and/or sold [471] to the "public" no later than May 25, 1984, the last investment date alleged by the plaintiffs. Thus, according to the defendants, the three-year outside limits on causes of action grounded on sections 12(1) and (2) expired in May 1987, some 17 months before the plaintiffs brought suit.

[1] The plaintiffs do not dispute the May 1984 trigger date. Instead, they argue that the three-year limits should be equitably tolled because the defendants actively concealed their fraudulent conduct. The plaintiffs read a discovery exception into the three-year provisions of section 13. They rely for the most part on *In re Gas Reclamation, Inc. Sec. Litig.*, 659 F.Supp. 493, 507-08 (S.D.N.Y. 1987) ("*Gas Reclamation*"), where the court concluded that section 13 does not begin to run on either a section 12(1) or 12(2) claim until the fraudulent concealment is discovered. *But see McLernon v. Source Int'l, Inc.*, 701 F.Supp. 1422, 1427 (E.D.Wis.1988) (by providing in section 13 a discovery exception for section 12(2) violations and omitting such an exception for section 12(1) violations, "[t]he logical conclusion is that Congress intended to prohibit application of a discovery rule to section 12(1) claims.")

Though the *Gas Reclamation* court undeniably read a discovery exception into section 13 as to section 12(1) claims, the case lacks the persuasive force intended by

the plaintiffs. The engrafted discovery exception pertained only to section 12(1) claims brought within one year after the violation occurred. 659 F.Supp. at 507-08. *See also Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1055 (2d Cir.1969). The *Gas Reclamation* court did not create a discovery exception to the three-year maximum prescribed in section 13. The plaintiffs have failed to identify any case that has allowed equitable tolling of the three-year limits allowed for 12(1) and 12(2) causes of action. The court has located only one such case. *See In re Home-Stake Prod. Co. Sec. Litig.*, 76 F.R.D. 337, 344-45 (N.D.Okla.1975).

In *Clute v. Davenport Co.*, 584 F.Supp. 1562, 1576-77 (D.Conn.1984) (Blumenfeld, J.), the court followed the "majority" rule and found that the three-year limit in section 13 is an absolute bar to claims based on sections 12(1) and 12(2). "If the three-year limit could be tolled, section 13 'would create a limitation period for all suits of one year from the time discovery of the untrue statements or omissions should have been made, and the three-year provision would serve no purpose at all.' " *Id.* at 1577 (quoting *Turner v. First Wis. Mortgage Trust*, 454 F.Supp. 899, 911 (E.D.Wis.1978)). The court aligns itself with *Clute*. The express language of section 13 demonstrates Congress' intent to place a three-year limit on the bringing of section 12 claims. *See Zola v. Gordon*, 685 F.Supp. 354, 360 & 361 n. 7 (S.D.N.Y.1988) (three-year period in section 13 "an absolute outer limitation," congressional intent clear that tolling of three-year limit not permitted). The court grants the defendants' Rule 12(b)(6) motions to dismiss the plaintiffs' causes of action premised on sections 12(1) and 12(2).

[2] As to the plaintiffs' section 17(a) cause of action,[2] the court grants the defendants' motion to dismiss without reaching the defendants' statute of limitations arguments. In *Rocco v. PaineWebber, Inc.*, Civ. No. N-88-509(AHN), slip op. at 3-5 (D.Conn. May 12, 1989), this court recently concluded that a private cause of action does not lie under section 17(a). No private right of action is expressly provided in section 17(a), but eleven years ago the second circuit held in *Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir.1978), *cert. denied sub nom. Goldberg v. Kirshner*, 444 U.S. 995, 100 S.Ct. 531, 62 L.Ed.2d 426 (1979), that an implied private right of action does exist under this statute. *Kirshner* has been criticized both within [472] and without this circuit. Moreover, the fifth, eighth, ninth and eleventh circuits have declined to recognize an implied right. *See Landry v. All Am. Assurance Co.*, 688 F.2d 381, 384-89 (5th Cir.1982); *Shull v. Dain, Kalman & Quail, Inc.*, 561 F.2d 152, 159 (8th Cir.1977), *cert. denied*, 434 U.S. 1086, 98 S.Ct. 1281, 55 L.Ed.2d 792 (1978); *In re Washington Pub. Power Supply Sys. Sec. Litig.*, 823 F.2d 1349, 1356 (9th Cir.1987) ("*WPPSS Sec. Litig.*"); *Currie v. Cayman Resources Corp.*, 835 F.2d 780, 784-85 (11th Cir.1988). Within this district there is a split of opinion on whether a private right of action exists under section 17(a). *Compare Weisman v. Oliver Rose Sec., Inc.*, Civ. No. B-85-126(EBB), slip op. at 18 (D.Conn. Nov. 10, 1987) (Burns, J.) (*Kirshner's* binding force has been weakened;

[2] The plaintiffs do not specify which subsection of section 17 their claim is based upon, but the court agrees with the defendants that subsection (a) is the most likely provision. As defendant Northwest notes in its supplemental memorandum in support of its motion, the plaintiffs have failed to address the defendants' challenges to section 17(a) and appear to have abandoned this cause of action. To remove any doubt the court dismisses the claim on the substantive grounds set forth in the text.

no private right of action) *with Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F.Supp. 1362, 1374 (D.Conn.1987) (Blumenfeld, J.) (*Kirshner* remains controlling precedent; private right of action exists).

The *en banc* panel in *WPPSS Sec. Litig.* performed a comprehensive and convincing review of section 17(a) private remedy jurisprudence before concluding that a private cause of action is not available under the statute. The court examined section 17(a) in the light cast by *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975), the Supreme Court's leading case on private rights of action. 823 F.2d at 1353-56. According to the *WPPSS Sec. Litig.* court,

> "The three factors which the Supreme Court has emphasized in applying the *Cort v. Ash* test—the statute's language, its legislative history, and its statutory scheme—all point in precisely the same direction: Congress did not intend in 1933 to create a private right of action under section 17(a). 'We are reluctant to tamper with an enforcement scheme crafted with such evident care .... "The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive system of procedures for enforcement." ' [*Massachusetts Mut. Life Ins. Co. v.*] *Russell*, 473 U.S. [134, 147, 105 S.Ct. 3085, 3093, 87 L.Ed.2d 96 (1985)] [quoting *Northwest Airlines, Inc. v. Transport Workers*, 451 U.S. [77, 97, 101 S.Ct. 1571, 1583-84, 67 L.Ed.2d 750 (1981)]. The [1933 Act] contained such an integrated scheme; unless the plaintiffs can establish that Congress later preserved a judicially-created private remedy under section 17(a), any decision to create such a right of action must be left to future congressional action.

WPPSS Sec. Litig., 823 F.2d at 1356.

In *Yoder v. Orthomolecular Nutrition Inst., Inc.*, 751 F.2d 555, 559 n. 3 (2d Cir.1985), the second ciruit indicated its willingness to reexamine *Kirshner*, a pre-*Cort* case. The second circuit's recent decision in *Asch v. Philips, Appel & Walden, Inc.*, 867 F.2d 776 (2d Cir.1989) (*per curiam*), provides strong evidence as to how the court of appeals would likely resolve the section 17(a) private right issue. After performing the three-part *Cort* analysis, the *Asch* court held that a private right of action does not lie under section 15(c)(1) of the 1934 Act, 15 U.S.C. Section 78*o*(c)(1), one of the anti-fraud provisions of that Act. 867 F.2d at 777. *Asch* buttresses the court's conclusion that no implied private right of action exists under section 17(a). The defendants' motion to dismiss is granted as to the section 17(a) claim.

2. 1934 Act

The complaint also alleges violations of section 10(b) of the 1934 Act, which does not contain a statute of limitations for section 10(b). When a federal statute lacks a limitations period, federal courts usually look to the law of the forum state. *UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696, 703-04, 86 S.Ct. 1107, 1111-13, 16 L.Ed.2d 192 (1966); *Arneil v. Ramsey*, 550 F.2d 774, 779 (2d Cir.1977). Federal courts in Connecticut have traditionally drawn upon the limitations period provided in the CUSA: "No person may sue under this section [i.e., buyer's remedies] more than two years after the contract of sale. . . ." Conn.Gen.Stat. Section 36-498(f). *See, e.g., Dandorph v. Fahnestock & Co.*, 462 F.Supp. 961, 963 (D.Conn.1979) (Burns, J.) [473] (law well settled in this district that two year statute applicable).[3] According to the defendants in the instant matter, it is clear from the plaintiffs' allegations that the contracts of sale in the

[3] Section 36-498(f) is a successor version of the statute at issue in *Dandorph*, Conn.Gen.Stat. Section 36-346(e).

Keystone limited partnerships were executed in May 1984 and that, therefore, the two-year limit of section 36-498(f) ran in May 1986.

[3, 4] Though a federal court turns to state law for reference to a limitations period on section 10(b) claims, it is federal law which determines when the period begins to run. *IIT, An Int'l Inv. Trust v. Cornfeld,* 619 F.2d 909, 929 (2d Cir. 1980) ("*IIT*"); *Arneil,* 550 F.2d at 780, In this circuit, the limitations period does not commence at the time of the sale of a security but "when the plaintiff has actual knowledge of the alleged fraud or knowledge of facts which in the exercise of reasonable diligence should have led to actual knowledge.' " *IIT,* 619 F.2d at 929 (quoting *Stull v. Bayard,* 561 F.2d 429, 432 (2d Cir.1977), *cert. denied,* 434 U.S. 1035, 98 S.Ct. 769, 54 L.Ed.2d 783 (1978)); *see also Berry Petroleum Co. v. Adams & Peck,* 518 F.2d 402, 410 (2d Cir.1975) (limitations statute "runs from the time at which plaintiff should have discovered the general fraudulent scheme"). This gloss on the two-year requirement of section 36-498(f) has been applied by several courts in this circuit. *See, e.g., Appel v. Kidder, Peabody & Co., Inc.,* 628 F.Supp. 153, 157-58 (S.D.N.Y.1986); *Clute,* 584 F.Supp. at 1577-79; *Dandorph,* 462 F.Supp. at 964.

[5] Before turning to the allegations of the complaint, one other principle deserves mention. In this circuit, a distinction is made between active and passive concealment of fraud when applying the equitable tolling doctrine to section 10(b) claims. "Passive concealment occurs when the defendant commits fraud but then takes no further action to disguise the fraud from the plaintiff.... [A]ctive concealment occurs when the defendant actually takes affirmative steps in addition to the original fraud to prevent plaintiff from discovering

the scheme." *Clute*, 584 F.Supp. at 1578 n. 4 (quoting *McConnell v. Frank Howard Allen & Co.*, 574 F.Supp. 781, 787-88 (N.D.Cal.1983)). In a passive concealment context, equitable tolling requires both concealment and a showing by the plaintiff that he used due diligence in seeking to discover the fraud. *Clute*, 584 F.Supp. at 1578. By contrast, "where there is active concealment, a plaintiff's due diligence is irrelevant." *Id.* (citing, among other cases, *Robertson v. Seidman & Seidman*, 609 F.2d 583, 593 (2d Cir.1979) ("[T]he active concealment of fraudulent conduct tolls the statute of limitations in favor of the defrauded party until such time as he actually knew of the fraudulent conduct of the opposing party.")).

With these guidelines in mind, the court concludes that the allegations of the complaint, when viewed in a light most favorable to the non-movants, are sufficient to survive a Rule 12(b)(6) statute of limitations challenge to the plaintiffs' section 10(b) claim. Some movants have provided the court with documentation (e.g., letters and affidavits) which purport to demonstrate the plaintiffs' actual knowledge of the alleged fraud at times beyond the two years preceding the initiation of suit. As it must in a Rule 12(b)(6) context, the court limits itself to the four corners of the complaint and accepts as true the plaintiffs' allegations that the defendants knew or should have known, for example, of the prior litigation history of John Meatte and that they failed to reveal this history to the plaintiffs on various occasions and in various documents predating October 17, 1986. According to the plaintiffs, they did not learn of the active concealment of the purported fraud underlying the Keystone project until 1987. For purposes of Rule 12(b)(6), the complaint satisfies the two-year requirement of section 36-498(f).

The defendants present an alternative argument on the statute of limitations issue. They urge the court to forgo the *ad hoc* limitations analysis associated with federal [474] application of section 36-498(f) for the uniform rule adopted by the third circuit in *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir.) (*en banc*) ("*Data Access*"), *cert. denied sub nom. Vitiello v. I. Kahlowsky & Co.*, _____ U.S. _____, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988). There, the court conducted a scholarly and comprehensive review of relevant Supreme Court decisions before concluding that "the Court is sending strong signals that we should adopt a uniform limitations period in [section 10(b) and Rule 10b-5] cases rather than try to color match each case with shifting state fraud statutes of repose." *Id.* at 1545. According to the court, "since uniformity is not to be found in the diverse body of state tort limitations, we are impelled inexorably to look to federal limitations for borrowing purposes." *Id.* at 1549. The third circuit also found that lack of uniformity "inheres in the plethora of state blue sky laws, which have widely varying statutes of limitations as well as disparate statutory coverage." *Id.*

The *Data Access* court held that "the federal schema of limitations expressly set forth in the [1934 Act] 'clearly provides a closer analogy than available state statutes,' . . . and that 'the federal policies at stake [in section 10(b) and Rule 10b-5 actions] and the practicalities of litigation make [the federal] rule a significantly more appropriate vehicle . . . .' " *Id.* at 1545 (quoting *DelCostello v. International Blvd. of Teamsters*, 462 U.S. 151, 172, 103 S.Ct. 2281, 2294, 76 L.Ed.2d 476 (1983)). After scrutinizing different sections of the federal securities laws that are companion provisions to section 10(b), the court of appeals concluded that it would adopt the express limitations period set forth in the 1934 Act.

> It is difficult to consider a limitations statute that better reflects the 'federal policies at stake' and the 'practicalities of litigation' in a case based on the [1934 Act] than those provisions of the Act that explicitly and expressly state such a period.... Indeed, because the Supreme Court opened the door to borrowing relevant federal limitations statutes, and in light of the congressional philosophy and purposes set forth in the 1933 and 1934 Acts that have been so consistently emphasized and implemented by the federal courts, it would seem bizarre if not anomalous to go beyond the express statutes of limitations contained in provisions of the 1934 Act.

843 F.2d at 1549. The uniform period adopted by the *Data Access* court for section 10(b) and Rule 10b-5 claims "is one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation." *Id.* at 1550. With a uniform federal statute of limitations, "[a] broker in New York, an issuer in Delaware, a purchaser in San Francisco, an accountant in New Jersey, and a lawyer in Pennsylvania [would] be subject to the same statute of limitations" for actions grounded on section 10(b) or Rule 10b-5. *Id.* at 1549. According to the defendants, application of the *Data Access* three-year rule would clearly preclude the plaintiffs' section 10(b) and Rule 10b-5 claims.

As might be expected following a groundbreaking and controversial decision, *Data Access* has generated varied responses from other courts. Several district courts outside the second and third circuits have agreed with the third circuit on this issue. *See, e.g., Kayne v. PaineWebber, Inc.*, 703 F.Supp. 1334, 1343 (N.D.Ill.1989) (reasoning of the third circuit in *Data Access* is "compelling"); *Bath v. Bushkin, Gaims, Gaines and*

Jonas, 695 F.Supp. 1156, 1159-62 (D.Wyo.1988) (noting that several Wyoming statutes could be applicable depending upon facts of case, court agrees with *Data Access* court that a single federal limitations period would enhance the federal interests in uniformity, certainty, and minimization of unnecessary litigation). The eleventh circuit has acknowledged *Data Access* but without discussing the third circuit opinion has continued to apply the forum state's limitations period which bears the closest resemblance to the section 10(b) claim. *Durham v. Business Management Assoc.*, 847 F.2d 1505, 1508 (11th Cir.1988). Some district courts have declined to follow *Data Access*. *See, e.g., In re Professional Fin. Manage-*[*475*] *ment, Ltd.*, 703 F.Supp. 1388, 1393 (D.Minn.1989) (adoption of the *Data Access* rule "would upset the well-settled rule in this circuit that the limitations period for section 10(b) and Rule 10b-5 claims is borrowed from the most analogous state statute"); *Marchese v. Nelson*, 700 F.Supp. 522, 523-24 (D.Utah 1988) (although "*Data Access* appears well-reasoned," "well-settled that federal courts sitting in Utah . . . required to apply" state law limitation period to section 10(b) and Rule 10b-5 claims); *TCF Banking and Savings, F.A. v. Arthur Young & Co.*, 697 F.Supp. 362, 365-66 (D.Minn.1988) (in borrowing from the state limitations period, court noted "law in [e]ighth [c]ircuit is much clearer and more settled than it had been in the [t]hird [c]ircuit prior to *Data Access*"). To date only two district courts in the second circuit have published opinions on this issue; they are split on the persuasive force behind *Data Access*. *Compare Metropolitan Sec. v. Occidental Petroleum Corp.*, 705 F.Supp. 134, 138 (S.D.N.Y.1989) ("In light of the customary rule of this [c]ircuit, and in the absence of conflicting authority from this [c]ircuit, the six-year limitation period [under New

York law] applies to" section 10(b) claims) *with Bernstein v. Crazy Eddie, Inc.*, 702 F.Supp. 962, 981 (E.D.N.Y.1988) ("This court finds the [t]hird [c]ircuit's reasoning sound and believes it highly likely that the [s]econd [c]ircuit will follow suit.")

The *Data Access* court expressly declined to address a critical issue pertaining to its newly formulated federal limitations period for section 10(b) and Rule 10b-5 claims: whether the limitations period should have prospective effect only. 843 F.2d at 1550. Three months after *Data Access*, however, the third circuit faced this issue in *Hill v. Equitable Trust Co.*, 851 F.2d 691 (3d Cir.1988). The *Hill* court held that the third circuit's ruling in *Data Access* should be applied retrospectively. *Id.* at 698-99. The later decision relied on the three-part test set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07, 92 S.Ct. 349, 355-56, 30 L.Ed.2d 296 (1971), for deciding whether a decision has future effect only:

> (1) The holding must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed;
>
> (2) The merits and demerits in each case must be weighed by looking to the history of the rule in dispute, its purpose and effect, and whether retrospective operation will further or retard the rule's operation;
>
> (3) Retrospective application must create the risk of producing substantially inequitable results.

After reviewing these criteria in some detail, the *Hill* court concluded that retroactive application of *Data Access* "to this case" would not be "contrary to *Chevron's* limited non-retrospectivity exception." 851 F.2d at 698.

Hill, like *Data Access*, has elicited its share of mixed reaction, primarily because the *Hill* court did not clearly indicate whether the *Data Access* rule should be retrospectively applied in all instances. Post-*Hill* courts have agreed on the relevance of the *Chevron* test but have reached varying results after applying the criteria to the facts of specific cases. *See, e.g., Kayne*, 703 F.Supp. at 1343-44 (on basis of facts before it, court declined to give retrospective application to *Data Access*); *Schwartz v. Philadelphia Nat'l Bank*, 701 F.Supp. 92, 97-98 (E.D.Pa.1988) (*Data Access* limitations period applied retroactively to facts before court).

The *Data Access* and *Hill* decisions raise several intriguing questions. Although the defendants have ably summarized the reasoning of the *Data Access* court, they have not fully addressed whether the decision would have a salutary or detrimental effect in this district, where it has been well settled that federal courts turn to section 36-498(f) of the Connecticut General Statutes for the limitations period applicable to section 10(b) and Rule 10b-5 claims. Moreover, the parties have not addressed the implications of *Hill* on the instant matter. The court invites further submissions on these questions, and any others the parties [476] deem relevant to resolution of the statute of limitations challenge to the plaintiffs' 1934 Act cause of action. Until that challenge is resolved after further briefing is completed, the court refrains from ruling on the defendants' other section 10(b) challenges. Optional simultaneous briefs shall be filed by September 11, 1989.

B. *State Law Causes of Action*

In the interests of judicial economy the court postpones until another day consideration of the defendants' challenges to counts three, four, five, and six.

The parties will not be substantially prejudiced by this delay. There being lack of complete diversity in this case, the plaintiffs have invoked the court's pendent jurisdiction over the state law claims. If, for the sake of argument, the defendants succeed in having the plaintiffs' section 10(b) claim dismissed, there will remain no federal question cause of action upon which to hang the pendent claims. Under these hypothetical circumstances, the court would decline to exercise jurisdiction over a case devoid of a federal predicate, unless presented with some compelling reason for retaining a purely non-federal suit. *See United Mine Workers of Am. v. Gibbs,* 383 U.S. 715, 726, 86 S.Ct. 1130, 1139, 16 L.Ed.2d 218 (1966) ("Certainly, if the federal claims are dismissed before trial, . . . the state claims should be dismissed as well.").

Conclusion

For the foregoing reasons, the court grants the defendants' Rule 12(b)(6), Fed.R.Civ.P., motions as to the plaintiffs' 1933 Act claims. The court invites further briefing on the 1934 Act claim, *see supra* section II.A.2; all briefs shall be filed by September 11, 1989.

SO ORDERED.

ON MOTION TO DISMISS §10(b) AND RULE 10b-5 ACTIONS

The facts of this case are set out in this court's prior partial ruling on a motion to dismiss, see p. 468, and will be reiterated here only where necessary. In that ruling, this court reserved decision on challenges to the complaint pertaining to plaintiffs' cause of action brought pursuant to Section 10(b) of the Securities Exchange Act of 1934, ("1934 Act"), 15 U.S.C. Section

78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. Section 240.10b-5. The court also requested briefing on the issues presented by these challenges.

The questions now presented are whether this court should follow the holding of *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir.) (en banc), *cert. denied*, _____ U.S. _____, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988), and if so, whether that rule should apply retroactively in this case.

I. *Application of Data Access—The Proper Statute of Limitations*

[6] It is by now well documented that neither section 10(b) nor rule 10b-5 contain an express statute of limitations, presumably because the private rights of action under this legislation are creatures of the judiciary. It is equally well settled that the Supreme Court has yet to rule on the applicable limitations period for such actions. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n. 29, 96 S.Ct. 1375, 1389 n. 29, 47 L.Ed.2d 668 (1976) Thus, inferior Article III courts have been left to their own devices to determine the applicable statute of limitations in each district, inevitably leading to a severe lack of uniformity nationwide.

Precedent in this circuit counsels that federal courts look to analogous state law to provide the period of limitations for section 10(b) and rule 10b-5 actions. *IIT v. Cornfeld*, 619 F.2d 909, 928 (2d Cir.1980); *see also Armstrong v. McAlpin*, 699 F.2d 79, 86 (2d Cir.1983). Consequently, courts in this district have drawn upon the two year period of limitations provided by Conn.Gen.Stat. Section 36-498(f) (Connecticut Uniform Securities Act). *See, e.g., Clute v. Davenport Co.*, 584 F.Supp. 1562, 1577 (D.Conn.1984); *Dandorph v. Fahnestock & Co.*, 462 F.Supp. 961, 963 (D.Conn.1979).

Today, this court is asked to disavow this precedent in favor of the emerging, well reasoned doctrine spawned by the *Data* [477] *Access* decision. While it is not the function of inferior federal courts to declare new doctrines, neither is it their function to blindly follow precedents based upon articulated premises now called into question by current Supreme Court trends. *See C.D.R. Enters, LTD. v. Bd. of Educ.*, 412 F.Supp. 1164, 1170 (E.D.N.Y.1976), *aff'd sub nom, Lefkowitz v. C.D.R. Enters, LTD.*, 429 U.S. 1031, 97 S.Ct. 721, 50 L.Ed.2d 742 (1977); *see also Quadrini v. Sikorsky Aircraft Div., United Aircraft Corp.*, 425 F.Supp. 81, 91 (D.Conn.1977) (Newman, J.). Since this court believes that the second circuit will adopt the reasoning and conclusion enunciated by the *Data Access* court, this court holds that the proper statute of limitations for claims under section 10(b) and rule 10b-5 is that statute of limitations applicable to other private rights of action under the 1934 Act—one year after the plaintiff discovers the facts constituting the violation, and in no event later than three years after such violation. *See, e.g.*, Section 9(e), 15 U.S.C. Section 78i(e) (1981).

A. *Second Circuit Precedent*

An exhaustive discussion of the evolution of this circuit's decisions concerning the issue presented here would be neither helpful nor necessary. A survey of the second circuit's more recent decisions sufficiently illustrates the premises upon which that court has based its decisions regarding the proper period of limitations applicable to implied federal securities law claims.

In *Arneil v. Ramsey*, 550 F.2d 774 (2d Cir.1977), investors in a brokerage firm brought suit against former officers of that firm alleging, *inter alia*, violations of

sections 10(b) and 20(a) of the 1934 Act. The investors claimed that the officers obtained badly needed capital without disclosing the unsound financial condition of the firm. A unanimous court reasoned that because section 10(b) did not specify a limitations period, a court must refer to the statute of limitations of the forum state to determine whether an action was timely. *Id.* at 779 (citing *UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696, 86 S.Ct. 1107, 16 L.Ed.2d 192 (1966); *Cope v. Anderson*, 331 U.S. 461, 67 S.Ct. 1340, 91 L.Ed. 1602 (1947)).[1]

The limitations period applicable to Section 14 of the 1934 Act was discussed in *Stull v. Bayard*, 561 F.2d 429 (2d Cir.1977), *cert. denied*, 434 U.S. 1035, 98 S.Ct. 769, 54 L.Ed.2d 783 (1978). There, the plaintiff brought a suit alleging that a series of misstatements and omissions by the defendants had induced him and other shareholders of a target company not to accept a stock exchange offer. No period of limitations was prescribed for actions brought under section 14. In such situations, the court held, federal courts should apply the statute of limitations of the forum state "which best effectuate[s] the policies underlying the federal statute." *Id.* at 431 (citing *Arneil*, 550 F.2d at 779).

More recently, the second circuit again addressed the statute of limitations applicable to section 10(b) in *Armstrong v. McAlpin*, 699 F.2d 79 (2d Cir.1983) and *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir.1980). In both cases, the court summarily found that an analogous law of the forum state supplied the appropriate statute of limitations. *Armstrong*, 699 F.2d at 86; *IIT*, 619 F.2d at 928.

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[1] Ostensibly feeling bound by Supreme Court precedent, the court did not proffer any additional legal or policy reasons for the stated proposition.

A reading of these second circuit decisions indicates that the respective courts felt constrained by the weight of precedent; these decisions were obviously based upon the well established foundation of precedent which held that when Congress has been silent as to the applicable statute of limitations, courts should adopt a local, analogous statute to fill this void. *See generally UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696, 86 S.Ct. 1107, 16 L.Ed.2d 192 (1966). It remains, however, whether erosion of this bedrock foundation would lead the second circuit to now reach a different result.

B. *Erosion of the Foundation: Malley-Duff, Wilson, and DelCostello*

The foundation upon which the holdings in *Arneil, Stull, IIT,* and *Armstrong* were [478] based is enunciated in *UAW v. Hoosier Cardinal Corp.*: "Since [*Campbell v. Haverhill,* 155 U.S. 610, 15 S.Ct. 217, 39 L.Ed. 280 (1895)], state statutes have repeatedly supplied the periods of limitations for federal causes of action when federal legislation has been silent on the question." *UAW,* 383 U.S. at 704, 86 S.Ct. at 1112 (footnote omitted). Courts have reasoned that Congress, by its silence, must have intended that state law apply, rather than having no statute of limitations. *DelCostello v. Int'l Bhd. of Teamsters,* 462 U.S. 151, 158-59, 103 S.Ct. 2281, 2287-88, 76 L.Ed.2d 476 (1983).[2] The cumulative effect of

[2] Although, it is questionable whether this reasoning applies to section 10(b) claims. As Judge Aldisert explained:

> Congress cannot be faulted for not providing a statute of limitations, because the section 10(b) private cause of action was not enacted by it; it is a genie sired solely by the judiciary, and the genie having escaped from the bottle is not easily cabined. So the courts resort to the political science fiction of

(Footnote continued on following page.)

three recent Supreme Court decisions, however, has called into question the efficacy of the principle's uniform application. *See Agency Holding Corp. v. Malley-Duff & Assocs.*, 483 U.S. 143, 107 S.Ct. 2759, 97 L.Ed.2d 121 (1987); *Wilson v. Garcia*, 471 U.S. 261, 105 S.Ct. 1938, 85 L.Ed.2d 254 (1985); *DelCostello*, 462 U.S. 151, 103 S.Ct. 2281.

In *DelCostello*, the question arose whether the Court should borrow a federal statute of limitations for actions against employers and unions arising under Section 301 of the Labor Management Relations Act, 29 U.S.C. Section 185 alleging breaches of a collective-bargaining agreement and of a duty of fair representation. *DelCostello*, 462 U.S. at 154-55, 103 S.Ct. at 2285-86.[3] While recognizing the generally accepted rule enunciated in *UAW*, *id.* at 159, 103 S.Ct. at 2287, the Court also noted that state limitations periods often were "unsatisfactory vehicles for the enforcement of federal law." *Id.* at 161, 103 S.Ct. at 2289. In such circumstances, "it may be inappropriate to conclude that Congress would choose to adopt state rules at odds with the purpose or operation of federal substantive law." *Id.*

(Footnote continued from preceding page.)

> formulating judically-declared "statutes" of limitations, suggesting that this would have been the intention of Congress had it created an express cause of action. It is a sort of hermaphroditic process: the courts invent the remedy and then seek to determine what would have been the intention of Congress as to a statute of limitations had it expressly created the private damage action.

Data Access, 843 F.2d at 1547. Since it is arguable whether Congress indeed intended to grant a private cause of action, it is likewise arguable that Congress intended that state law supply the proper statute of limitations.

[3] The limitations period being considered was contained in section 10(b) of the NLRA, 29 U.S.C. Section 160(b).

Thus, in rejecting an exclusive, mechanical application of state statutes of limitation, the Court recognized "the duty of the federal courts to assure that the importation of state law will not frustrate or interfere with the implementation of national policies." *Id.* (citations omitted). The court held therefore that the federal limitations period applied, reasoning that

> when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking, we have not hesitated to turn away from state law.

Id. at 172, 103 S.Ct. at 2294.

Building upon the foundation laid in *DelCostello,* the Supreme Court, in *Malloy-Duff* and *Wilson,* adopted a three prong test to determine the appropriate limitations period for federal claims without express statutes of limitation. A court must determine: (1) whether state law or federal law governs characterization of the federal claim; (2) if federal law applies, whether all such federal claims should be characterized in the same way, or whether they should be characterized differently depending upon changing factual circumstances and legal theories; and (3) whether a federal or state statute of limitations should be used. *Malloy-Duff,* 483 U.S. at 147, 107 S.Ct. at 2762; *Wilson,* 471 U.S. at 268, 105 S.Ct. at 1942.

1. Characterization of the Claim

[7] Characterization of a federal claim for the purposes of selecting the appropri-[479] ate statute of limitations is generally a question of federal law. *Malloy-Duff,* 483 U.S. at 147, 107 S.Ct. at 2762; *Wilson,* 471

U.S. at 269-70, 105 S.Ct. at 1943-44; *Data Access*, 843 F.2d at 1542. A court must next address the need for, and desirability of, a uniform period of limitations. In this context, the Supreme Court itself has recognized that " '[f]ew areas of law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations.' " *Wilson*, 471 U.S. at 266, 105 S.Ct. at 1941 (quoting *Chardon v. Fumero Soto*, 462 U.S. 650, 667, 103 S.Ct. 2611, 2622, 77 L.Ed.2d 74 (1983) (Rehnquist, J., dissenting)). Nonetheless, current developments in this area have led courts and commentators alike to lament the conspicuous absence of uniformity. *See, e.g., Norris v. Wirtz*, 818 F.2d 1329, 1332 (7th Cir.) (Easterbrook, J.), *cert. denied*, 484 U.S. 943, 108 S.Ct. 329, 98 L.Ed.2d 356 (1987); L. Loss, *Fundamentals of Securities Regulation* 992-1003 (2d ed. 1988 & Supp.1989).

Currently, this circuit looks to the law of the forum state to determine the appropriate limitations period. In turn, that state's law often requires that a court borrow the limitations period of the law of the state where the plaintiff resides or where the cause of action accrued, frequently requiring a complex, convoluted analysis. *See, e.g., Zola v. Gordon*, 685 F.Supp. 354 (S.D.N.Y.1988). Thus, which statute applies necessarily depends upon factual circumstances. It is possible to envision, therefore, a suit by many plaintiffs, each from a different state, in which a different statute of limitations would apply to each plaintiff. *See, e.g., Kronfeld v. Advest, Inc.*, 675 F.Supp. 1449, 1457-58 & n. 21 (S.D.N.Y. 1987) (court borrowed the applicable statute of limitations for a New York plaintiff and each of the non-resident plaintiffs, applying a total of 26 statutes of limitation).[4]

[4] Such cases have been deemed a *reductio ad absurdum* argument for the application of a uniform limitations period. *See* L. Loss, *Fundamentals of Securities Regulation* 994-95 (2d ed. 1988 & Supp.1989).

Such an approach hardly promotes the "federal interests in uniformity, certainty, and the minimization of unnecessary litigation." *Wilson*, 471 U.S. at 275, 105 S.Ct. at 1947; *see also Malley-Duff*, 483 U.S. at 148, 107 S.Ct. at 2763. This approach has also led to the application of a different statute of limitations by the district courts in each of the states comprising this circuit. *See, e.g., Metropolitan Sec. v. Occidental Petroleum Corp.*, 705 F.Supp. 134, 138 (S.D.N.Y.1989) (New York's statute of limitations applied); *Clute v. Davenport Co.*, 584 F.Supp. 1562, 1577 (D.Conn.1984) (Connecticut's statute of limitations applied); *Bartels v. Algonquin Properties, Ltd.*, 471 F.Supp. 1132, 1147 (D. Vt.1979) (Vermont's statute of limitations applied). Further disparate results would occur within this circuit if district courts within the same state disagreed as to the proper period of limitations, that is, disagreed as to which state claim is most analogous to a section 10(b) action.

The phenomena discussed invariably encourage plaintiffs to file strike suits for claims which may be stale or groundless. Forum shopping, a long disfavored practice, *see Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 74-77, 58 S.Ct. 817, 820-822, 82 L.Ed. 1188 (1938), has also ensued from the lack of uniformity, and there is little reason to believe that it will not continue to flourish. Residents of various states are granted different degrees of protection under federal causes of action based solely upon where they live or where their claims accrued. Surely this was not the intent of Congress. *Cf. Wilson*, 471 U.S. at 274-75, 105 S.Ct. at 1945-47 ("[U]nder such an approach different statutes of limitations would be applied to the various section 1983 claims arising in the same State, and multiple periods of limitations would often apply to the same case. . . . (Congress would [not]

have sanctioned this interpretation of its statute."). For reasons similar to those expressed in *Malley-Duff, Wilson, DelCostello,* and *Data Access,* therefore, this court finds that all claims arising under section 10(b) should be characterized in the same way.

[480] 2. The Appropiate Choice of Law: Federal or State Periods of Limitation

The next inquiry this court must conduct is whether a federal or state statute of limitations should be borrowed. The *DelCostello* Court explained that when a federal statute does not contain a limitations period, the Court has generally concluded that "Congress intended that the courts apply the most closely analogous statute of limitations under state law." 462 U.S. at 158, 103 S.Ct. at 2287. As mentioned, this reasoning may not apply with full force to Section 10(b) actions. *See supra* footnote 2. Moreover, precedent establishes that " 'the silence of Congress is not to be read as automatically putting an imprimatur on state law. Rather, state law is applied only because it supplements and fulfills federal policy, and the ultimate question is what federal policy requires.' " *Wilson,* 471 U.S. at 271 n. 20, 105 S.Ct. at 1944 n. 20 (quoting *UAW v. Hoosier Cardinal Corp.,* 383 U.S. 696, 709, 86 S.Ct. 1107, 1115, 16 L.Ed.2d 192 (1966) (White, J., dissenting)).

Although it has been suggested that an analogous state statute of limitations should always be borrowed when a federal statute contains no period of limitations, "a clear majority of the Court [has] rejected such a single path." *Malley-Duff,* 483 U.S. at 146, 107 S.Ct. at 2762 (citing *DelCostello,* 462 U.S. at 158-59, 103 S.Ct. at 2287-88). Instead, courts are instructed to borrow the statute of limitations from a rule which provides the closest analogy to the implied cause of action. *Malley-Duff,* 483

U.S. at 150, 107 S.Ct. at 2764; *DelCostello,* 462 U.S. at 172, 103 S.Ct. at 2294; *Data Access,* 843 F.2d at 1548. Thus, "when the federal policies at stake and the practicalities of litigation make [a federal] rule a significantly more appropriate vehicle for interstitial lawmaking," *DelCostello,* 462 U.S. at 172, 103 S.Ct. at 2294; see also *Malley-Duff,* 483 U.S. at 153, 107 S.Ct. at 2765; *Data Access,* 843 F.2d at 1548, courts should borrow the federal limitations period. This court finds that Section 10(b) bears "a far closer analogy to [companion provisions in the 1934 Act] than any state alternative." *Malley-Duff,* 483 U.S. at 150, 107 S.Ct. at 2764; *see also, Data Access,* 843 F.2d at 1548.

Section 10(b) and its companion provisions are all aimed at the same objectives: "to 'provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof. . . .' " *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 728, 95 S.Ct. 1917, 1921, 44 L.Ed.2d 539 (1975) (quoting the 1933 Act). Moreover, all of these provisions, except 16(b), contain a uniform federal limitations period—one year from the date of discovery of the fraud and no greater than three years from the date of such violation. This court finds that this limitations period reflects "the balance that Congress would have preferred between the substantive policies underlying the federal claims and the policies of repose." *Wilson,* 471 U.S. at 270, 105 S.Ct. at 1944. As Judge Easterbrook so eloquently explained, "[t]he legislative history [of the 1934 Act] makes it pellucid that Congress included statutes of repose because of fear that lingering liabilities would disrupt normal business and facilitate false claims. It was understood that the three-year rule was to be absolute."

Norris v. Wirtz, 818 F.2d 1329, 1332 (7th Cir.1987) (citing H.R.Conf. Reg. No. 1838, 73d Cong., 2d Ses. 32, 36, 42 (1934); 78 Cong.Rec. 8198—8203 (May 7, 1934); 6 J.S. Ellenberger & P. Mahar, *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934* 6565-66, 6718, 6993 (1973)). Furthermore, the American Bar Association Task Force on the Statute of Limitations for Implied Causes of Actions unequivocally concluded that "Congress did not intend equitable tolling to apply in actions under the securities laws." *Report of the Task Force on Statute of Limitations for Implied Actions*, 41 Bus.Law. 645, 655 (1986).

Logic also dictates reference to the limitations periods expressly provided by the 1934 Act. As one eminent scholar reasoned:

> [W]ith the 1933 and 1934 Acts so closely related, why not look to *their* statutes of limitations by way of analogy rather than to a variant state law? Would it [481] not be eminently more consistent with the overall statutory scheme to look to what Congress itself did when it was thinking specifically of private actions in securities cases rather than to a grabbag of more or less analogous state statutes?

L. Loss, *Fundamentals of Securities Regulation* 995 (2d ed. 1988). In this context, any analogy to state law is bound to be imperfect. *Wilson*, 471 U.S. at 273, 105 S.Ct. at 1945.

The facts of this case painfully illustrate how absorption of state statutes of limitations frustrates Congressional intent and the schema of federal securities law. Here, plaintiffs purchased securities in May 1984. However, they did not file this action until October 1988. Under the two year limitation period provided by Conn.Gen.Stat. Section 36-498(f), plaintiffs claim would be time barred in May 1986. The plaintiffs allege,

however, that they did not discover the fraud until early 1987. Thus, equitable tolling of the statute would allow the plaintiffs to bring this suit nearly four and a half years after the alleged fraud. Such a result would clearly countermand Congressional intent and would be contrary to the federal schema of limitations expressly set forth in the 1934 Act.

Courts' responses to the *Data Access* opinion have been diverse. *See* p. 468. While a district court within this circuit has embraced the *Data Access* holding, *see Bernstein v. Crazy Eddie, Inc.*, 702 F.Supp. 962, 981 (E.D.N.Y.1988) (*Data Access* court's reasoning sound, highly likely that second circuit will follow suit), other courts have declined to take that step. *See, e.g., Huang v. Sentinel Gov't Sec.*, 709 F.Supp. 1290, 1301 n. 10 (S.D.N.Y.1989) (clear law in this circuit dictates application of analogous state limitations statute); *Metropolitan Sec. v. Occidental Petroleum Corp.*, 705 F.Supp. 134, 138 (S.D.N.Y.1989) (In light of customary rule in this circuit, and absence of conflicting authority from circuit, analogous state limitations statute applies).

Courts declining to adopt *Data Access* have almost exclusively done so on the basis of existing contrary precedent. *See e.g., Huang*, 709 F.Supp. at 1301 n. 10. In *Eickhorst v. Am. Completion and Dev. Corp.*, 706 F.Supp. 1087 (S.D.N.Y.1989), however, the district court concluded that the reasoning of *Data Access* was inapplicable in this circuit, and, in any event, that *Malley-Duff* did not compel the result reached in *Data Access*. *Id.* at 1102. The *Eickhorst* court found that, unlike the third circuit, the law in this circuit regarding the applicable limitations period in section 10(b) actions was clear. *Id.* at 1100. This argument misses its mark, however. While it is true that the law of the third circuit

was confused in this area, it was the factually and legally based inquiries themselves which the *Data Access* court eschewed. In this circuit, such inquiries, that is, inquiries concerning the residency of the plaintiff(s) and where the 10(b) claim accrued, are still necessary under the currently applied analysis. Moreover, the desire to promote "federal interests in uniformity, certainty, and minimization of unnecessary litigation," *Wilson*, 471 U.S. at 275, 105 S.Ct. at 1947, and to prevent frustration or interference with the implementation of important federal policies, *DelCostello*, 462 U.S. at 162, 103 S.Ct. at 2289, were at the heart of the *Data Access* decision. These concerns are implicated even when the law within a particular circuit is well settled.

The *Eickhorst* court also found that the differences between RICO claims, at issue in *Malley-Duff*, and section 10(b) claims sufficiently undermined the persuasive value of Malley-Duff; "Malley-Duff does not *compel* a departure from the longstanding practice in this Circuit." *Id.* at 1102 (emphasis added). While *Malley-Duff* alone may not compel the result this court reaches today, surely the cumulative effect of *Malley-Duff*, *Wilson*, and *DelCostello* suggests an alternative path. Although this trilogy does not obliterate the foundation of precedent upon which this circuit's analysis is presently based, surely it disturbs its moorings. This court therefore finds the distinctions asserted in *Eickhorst* unpersuasive.

[482] A recent second circuit decision may sound in harmony with the decision reached today. In *Singer v. Olympia Brewing Co.*, 878 F.2d 596 (2d Cir.1989), *cert. denied*, _____ U.S. _____, 110 S.Ct. 729, 107 L.Ed.2d 748 (1990), the court addressed the problem of setoff in a section 10(b) context. The question presented was

whether in a 10b-5 cause of action the federal securities laws incorporate the state law of setoff or require a uniform federal rule of setoff. *Id.* at 599. The Court reasoned that:

> [A]doption of state statutes governing credit for settlement would lead to disparate results in cases in which (1) the state statutes differed or (2) state interpretation of similarly worded statutes differed. Because most securities fraud actions involve multiple parties from various states and in many cases at least some of the defendants settle, the incentive to forum-shop for favorable state rules would be heightened in many cases.

Id. at 600.[5] The Court held therefore that a uniform federal rule was appropriate in this context.

For the foregoing reasons, as well as the reasons stated by the third circuit in *Data Access*, this court finds that the appropriate limitations period for section 10(b) actions is that period contained in sister provisions of the 1934 Act—one year from the date the fraud is discovered, and in no event later than three years from the date of such violation.

II. *Retroactive Application of the Data Access Doctrine*

Since this court has determined that the rule in *Data Access* will be adopted by the second circuit, it must now discern whether that rule should be applied retroactively in this case.

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[5] The court also noted that setoff affected substantive rights. The court commented that most circuits have, in securities actions, incorporated state statutes for procedural matters, such as statutes of limitations. (The court also noted that *Data Access* had challenged this doctrine.) Since the adoption of setoff governs substantive rights, the court found this doctrine inapplicable. *Singer*, 878 F.2d at 599-600.

It has long been recognized that as a general rule, judicial precedents normally have retroactive as well as prospective effect. *Thorpe v. Hous. Auth.*, 393 U.S. 268, 281, 89 S.Ct. 518, 525, 21 L.Ed.2d 474 (1969); *Byrne v. Buffalo Creek R.R. Co.*, 765 F.2d 364, 366 (2d Cir.1985); *Kremer v. Chemical Constr. Corp.*, 623 F.2d 786, 788 (2d Cir.1980); *aff'd*, 456 U.S. 461, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982). Only in exceptional circumstances will a court stray from this path. *See, e.g., Byrne*, 765 F.2d at 366 (considering large amount of time and money invested in case, and that suit was commenced eight years before decision changing applicable statute of limitations, suit not time barred). In the seminal case on this subject, *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971), the Supreme Court fashioned a three part test to determine whether a decision should be applied only prospectively:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its application." Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Id. at 106-07, 92 S.Ct. at 355-56 (citations omitted).

Subsequent decisions have established that each of these factors must be satisfied or the decision will be applied retroactively. *See Holzsager v. Valley Hosp.*, 646 F.2d 792, 797-98 (2d Cir.1981); *Kremer*, 623 F.2d at 789-90. Moreover, the party opposing retroactive application bears the burden of satisfying the *Chevron* test. *Cash v. Califano*, 621 F.2d 626, 629 (4th [483] Cir.1980); *Harpp v. General Elec. Co.*, 571 F.Supp. 426, 432 (N.D.N.Y.1983). For the reasons stated below, this court finds that the plaintiff has failed to meet this burden.

In examining the first prong of the *Chevron* inquiry, prior precedent must have been sufficiently well settled that a plaintiff " 'could have reasonably relied upon it in delaying suit.' " *Hill v. Equitable Trust Co.*, 851 F.2d 691, 696 (3d Cir.1988) (citation omitted), *cert. denied*, _____ U.S. _____, 109 S.Ct. 791, 102 L.Ed.2d 782 (1989). Thus, a court must examine the state of the law both at the time which the plaintiff should have discovered the suit and the date on which the suit was filed. *Id.* at 697; *Heineman v. S & S Mach. Co.*, 707 F.Supp. 86, 90 (E.D.N.Y.1989).

The sale of the securities in question took place on May 25, 1984. Plaintiffs allege that defendants' violations of the securities laws also began that day. Plaintiffs' Complaint para. 36. It is also alleged, however, that some of the plaintiffs did not discover these violations until approximately March 1987. *Id.* paras. 29-30. Yet the plaintiffs' suit was not commenced until October 17, 1988.

At the time the violations were discovered, March 1987, the law in this circuit mandated that an *analogous* law of the forum state supply the appropriate period of limitations in a section 10(b) action. *See IIT v. Cornfeld*, 619 F.2d 909 (2d Cir.1980). Likewise, it was settled in

this district that Conn.Gen.Stat. Section 36-498(f) supplied the most analogous state law. *See Clute v. Davenport*, 584 F.Supp. 1562 (D.Conn.1984). It is noteworthy, however, that the second circuit has never confirmed that section 36-498(f) is indeed the most analogous state law, although it has made similar determinations for districts courts in other states. *See, e.g., Armstrong v. McAlpin*, 699 F.2d 79, 86 (2d Cir.1983) (appropriate limitations period for federal securities law action brought in New York districts courts in New York State's limitations period for common law fraud). Absolute reliance on section 36-498(f) as the definitive, analogous state law in this district may have therefore been unwise. Further, three Supreme Court decisions which shook the foundation of this circuit's precedent, *Malley-Duff* (decided April 1987), *Wilson* (decided April 1985), and *DelCostello* (decided June 1983), were all decided before the plaintiffs commenced their suit and before the three year statute of repose had expired on May 25, 1987. This should have caused a reasonably prudent attorney to at least question the value of precedent in this district.

[8] Finally, if the two year limitations period of Conn.Gen.Stat. Section 36-498(f) were woodenly applied, plaintiffs' action would have been time barred after May 1986. However, because federal law determines when the period begins to run, *Armstrong*, 699 F.2d at 86, the action did not accrue until the plaintiffs knew or had reason to know a fraud occurred. *IIT*, 619 F.2d at 929. Thus, plaintiffs' cause of action would not be time barred since this court found that they first learned of the frauds sometime in 1987. But hindsight is twenty-twenty. Plaintiffs could not have reasonably relied on the fact that this court would so hold. Although application of federal law to toll the state statute was almost certain,

exactly when this court would deem the cause of action to have accrued was not. *See Armstrong,* 699 F.2d at 88 (since plaintiffs could have discovered fraud more than two years prior to commencement of their action, 10(b) claim was time barred as to conduct before that date). Plaintiffs nonetheless waited more than a year and a half after they discovered the fraud before filing this suit. It is not altogether clear, then, that plaintiffs' reliance, if any, was reasonable. Even conceding plaintiffs the first criterion, however, plaintiffs fail to meet *Chevron's* other two conditions.

Courts have generally found that resolution of the second Chevron criterion—whether retrospective operation would further or retard the rule's application--is neutral. *See, e.g., Hill,* 851 F.2d at 698. As such, plaintiffs have not met their burden. But they fail this prong for another reason. Plaintiffs have offered no persuasive argument why the purposes of the [484] Securities Act would be retarded by retroactive application of the rule in *Data Access.* Arguably, barring plaintiffs' claim at this juncture frustrates the "broad remedial purpose behind the Securities Exchange Act of 1934." *Heineman,* 707 F.Supp. at 91. It is clear, however, that the three year statute of repose struck the balance between this concern and the "fear that lingering liabilities would disrupt normal business and facilitate false claims." *Norris v. Wirtz,* 818 F.2d 1329, 1332 (7th Cir.1987) (Easterbrook, J.). Allowing plaintiffs to maintain a suit more than a year and a half after the statute of repose has expired would frustrate not only the rule in *Data Access,* but the schema of the 1934 Act as well. Plaintiffs therefore fail the second prong of *Chevron.*

[9] Lastly, this court must weigh the inequity imposed by retroactive application of the *Data Access* rule. Plaintiffs beg the question by asserting that retroactive application of this rule is inequitable because it would operate to bar their suit. It is clear that the untimeliness of the plaintiffs' own actions can weigh into the equities. *Garguil v. Tompkins,* 790 F.2d 65, 274 (2d Cir.1986). Here, plaintiffs' inaction played a "prominent role in using up the limitations period." *Holzsager,* 646 F.2d at 798. They filed suit nearly four and a half years after the alleged fraud occurred. Moreover, at the time they discovered the fraud, their claim was already nearly three years old. Plaintiffs nevertheless waited another year and a half before filing suit. Such laxity demonstrates both the plaintiffs' lack of reliance on *any* statute and their willingness to expose themselves to substantial risk of losing their claims.

On the other hand, inequity to the defendants must also be considered in this context. *Stanulonis v. Marzec,* 649 F.Supp. 1536, 1542 (D.Conn.1986) (Dorsey, J.). Statutes of repose are "designed to deal with the problems of proof—and the invitation to file claims easier to advance than refute—that arise if long delayed litigation is permissible." *Norris,* 818 F.2d at 1333. Indeed, the Supreme Court itself has stated that:

> The statute of limitations is a statute of repose, designed to protect the citizens from stale and vexatious claims, and to make an end to the possibility of litigation after the lapse of a reasonable time. It has long been regarded by this Court . . . as a meritorious defense, in itself serving a public interest.

Guaranty Trust Co. v. United States, 304 U.S. 126, 136, 58 S.Ct. 785, 790, 82 L.Ed. 1224 (1938). This court finds that a weighing of the equities tips the scale in favor of

the defendants; retroactive application of this ruling would not produce "substantial inequitable results." *Chevron*, 404 U.S. at 107, 92 S.Ct. at 355.

Conclusion

For the foregoing reasons, the court grants the defendants motion to dismiss the federal securities fraud claim.

SO ORDERED.